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PREFACE TO FIRST EDITION.

ALTHOUGH the present volume has considerably exceeded the limits originally arranged between myself and the publishers, I cannot but feel that the vast subject to which I have addressed myself is very far from being exhaustively treated in the following pages. In particular, I feel that the chapter dealing with the audit of different classes of undertakings is, in spite of its considerable length, very far from complete; and, further, I regret that space has altogether failed me for a more full discussion of the various legal decisions that affect the duties and responsibilities of the profession.

On the other hand, I venture to hope that the present attempt to combine, within the limits of a volume of convenient size and reasonable price, the leading principles that should guide the Auditor in the course of his investigations, together with the special points that require his consideration in the case of any particular concern, will be found not only of considerable value to the Accountant Student—whose opportunities of gaining experience are, naturally, somewhat limited—but also of some utility to practising members of the profession, both in the ordinary course of their daily routine, and also—more especially—when they find themselves face to face with the accounts of a business with which they have hitherto been unfamiliar.

If it should be thought that the standard I have throughout advocated is somewhat Utopian in character, and unattainable in practice, I can only reply that I maintain that, to me, an incomplete investigation seems worse than useless; and I am convinced that it is only by voluntarily accepting, and even increasing, the responsibilities of our position that we can hope to maintain and to increase the large measure of public confidence we at present enjoy.

It would be impossible for me to specifically acknowledge my indebtedness to all the various members of the profession whose valuable opinions have so materially assisted me in the production of this work; but none the less, I desire to thank them most cordially for the benefits I have received from their experience.

In conclusion, I would wish to add that, as I have laid no claim to completeness in this work, so also do I wish to disclaim any assumption of absolute finality; and, accordingly, I shall consider myself greatly indebted to my readers for any suggestions and opinions with which they may be pleased to favour me, which, I need hardly add, shall receive every attention upon the publication of a new edition.

LAWRENCE R. DICKSEE.

Cardiff, 13th July 1892.

PREFACE TO FOURTH EDITION.

SINCE this work was first published some eight years ago, three editions of 1,000 copies each have been exhausted, without, apparently, in any way satisfying the demand, which continues to increase.

In each successive edition I have spared no effort to bring the work as closely up to date as possible, and also to include all matter that appears to fairly come within the scope that was originally contemplated. This has naturally necessitated a very material increase in size, as compared with the first edition, partly on account of recent legislation, but more especially on account of recent legal decisions. It is noteworthy, however, that, although almost all the decisions affecting the rights and duties of Auditors have been given since the first edition of this work was published, it has not been found necessary to alter materially any of the views that were originally expressed. Additional space has, however, been devoted to their further discussion and elucidation.

I gladly take advantage of the opportunity afforded by this Preface of expressing my indebtedness to numerous members of the profession for valuable suggestions received. In particular is it my desire to express my thanks to Mr. Adam Murray, F.C.A., for many hints of the greatest importance.

LAWRENCE R. DICKSEE.

Copthall House,

London, E.C.

24th September 1900.

CHAPTER I.

INTRODUCTORY.

AUDITING (up to the Trial Balance.)

PRELIMINARY CONSIDERATIONS.—The first point that claims attention is the method, or system, upon which an audit should be conducted; and here on the outset, one is brought face to face with some very considerable differences of opinion and practice among members of the profession.

It is mentioned by Mr. G. P. NORTON, F.C.A., that the practice of his firm (Armitage & Norton) is to have "certain printed instructions of a general character which are bound in small note-books, together with a number of spare blank leaves for memoranda. At the commencement of a new audit, one of the note-books is appropriated to it, and the general instructions are carefully revised and special instructions supplemented. The clerk who has this book with him, is thus shown precisely what are his duties with regard to the audit upon which he is engaged." The late Mr. C. R. TREVOR, F.C.A., in a lecture of somewhat earlier date, advocated a similar practice. He said: "The practice of having an Audit Book for each audit is highly important, with columns for the initials of each person who has performed the work, and made himself responsible for its having been correctly and thoroughly done. By this means much labour is saved on a second audit, and thorough continuity secured." It may be noticed that Mr. TREVOR made no mention here of any "instructions," but his remarks clearly pre-suppose the Audit Book to contain a definite list of duties to be performed.

Since the issue of the first edition of this work the author has published an "Audit Note-Book," the demand for which is sufficient to prove that the use of such a book is very general among the profession.

On the other hand, it has been suggested "that if a competent clerk is sent to undertake an audit (and none but competent clerks *should* be sent), it is much the better way to leave him unfettered with printed instructions, but allow him to go thoroughly into the whole system in operation, and from the nature of such system, and from what he sees, let him outline his own method of procedure. By this means there is not so much danger of his getting into a semi-careless groove of working, and moreover he feels that more responsibility is placed upon him, which acts as an incentive to do the work more thoroughly than would be the case were he working to 'rule of thumb'." There is, doubtless, something to be said upon this side of the question; but if so much be left to the clerk, it is a little difficult to see what the principal is expected to do himself. In any case, however, the book is useful as a record of the routine work performed and of the queries raised in the course of audit. It is believed that, in point of fact, some sort of Audit Note-Book is almost invariably used by most accountants at the present time.

The late Mr. DAVID CHADWICK, F.C.A.—after an experience of upwards of fifty years—was distinctly in favour of a stereotyped set of instructions. The set used in his office (which is given below) is especially full and complete; and, although, of course but a mere indication of an Auditor's duties, it will be found extremely suggestive:—

INSTRUCTIONS FOR AUDIT.

1. In commencing a new audit you should obtain a list of all the books kept, and of all persons authorised to receive or pay money and order goods.

2. In the case of a joint stock company, examine the articles and board minutes respecting the receipt and payment of money, and the drawing of cheques, acceptances, &c.

3. Ascertain and take note of the general system upon which the books are constructed, and the plan of checking the correctness of the accounts paid, and whether exclusively or generally by cheques.

4. Report if the accounts and vouchers are submitted to the board of directors by an account committee or otherwise, and whether they are systematically checked and certified; and note any discrepancies.

5. Examine all the items in the Cash Book with the Bank Pass Books and vouchers, and put your usual audit initials in the Pass Book and to every item in the Cash Book. Ascertain if the Bankers' Pass Book is frequently entered up and examined.

6. Note any unusual or extraordinary payments or receipts.

7. In regard to the payments for wages and petty cash, note any unusual items, and see that vouchers for all payments are kept and produced.

8. Report whether a rough Cash Book is kept, and whether the fair Cash Book is regularly and punctually posted and balanced, and if the balance is checked.

9. Report also if the entries in the fair Cash Book are in arrear, on account of the current year; and if so, to what extent, and why.

10. In all cases where branch establishments are included in one business, you will be careful to examine into the mode of bringing the returns of work, accounts, and expenses to the head office.

11. Examine all the Day Books, and see that the proper returns of purchases and sales are made by each department, and that the Bought and Sold Books are properly entered up; that the invoices are properly checked as to quantities and prices; obtain a declaration, or otherwise satisfy yourself, that every liability of the year is brought into account.

12. The postings in the Personal Ledgers must be checked from the Bought and Sold Day Books and the Cash Book, and also from the Bill Books and Journal.

13. The postings in the Nominal or Impersonal Ledgers must be checked from the journalising of the Bought and Sold Day Books, the Bill Books, the Invoice Books, and the Cash Books, and the mode and correctness of the journalising must be carefully proved.

14. Examine the Bills Receivable and Bills Payable Books, and note any item of past due, renewed or dishonoured bills, and make list of same and of the securities, if any.

15. Examine the entries and transfers passed through the Journal, and check the postings; and, although you are not held responsible for the details of classification, it is desirable you should make any suggestions required, and note any discrepancies, especially in relation to the division of expenditure on account of Capital and Profit and Loss Accounts respectively.

16. Examine the Share Register, and see that the amounts received for calls agree with the entries in the Bank Pass Books, and that they are correctly posted to the credit of the respective shareholders in the Share Ledger: that all transfers from the transfer deeds are duly stamped and entered in the Register of Transfers; and also that the amount of the subscribed and paid-up capital and arrears corresponds with the Balance Sheet.

17. Examine the register of all mortgages on the company's property, and all debenture bonds issued, and note and check the amount of capital paid in advance of calls, and of the receipts and payments in respect thereof with the Bank Pass Book.

18. In the accounts of stock-taking see that all stock sheets and returns are duly signed by the heads of departments, and that the same are correctly carried forward to the General Stock Account; and ascertain and note whether goods finished or in progress are taken at cost price or otherwise; also report whether in large concerns an independent check clerk or valuer has verified the stock returns in regard to prices and quantities.

19. In checking the Profit and Loss Account, note whether the usual and proper deductions are made for wear and tear and depreciation, and for recouping of capital on works or premises held on short leases.

20. Take care that in the Balance Sheet no additions are made to expenditure on Capital Account, except such as are duly authorised by the board of directors, and note the distinction between new works and mere replacements.

21. Ascertain whether the conveyance deeds and other securities specified in the agreement of purchase and articles of association have been duly executed, and the sums paid by the company on account of purchase have been duly endorsed thereon or otherwise acknowledged to the satisfaction of the solicitors or board of directors; also that the existence and safe custody of these documents has been duly certified; ascertain by application to the bankers the correctness of any balances, bills, or securities lodged with them.

22. Ascertain the correctness of the cash balances, bills, and other securities in hand, and take note of every exceptional transaction.

To sum up, then, the matter may be stated thus:—At the commencement of an audit, the principal should, if possible, go over the ground personally, and decide what work requires to be done. A list of such work (together with any other special notes that may seem desirable) should be entered in the Audit Note-Book, which should be ruled in columns, so that the initials of a clerk against any item may clearly show that he is responsible for the correctness of that item for the period named at the head of the column. In most cases it is practicable to keep books ready printed which, with but slight alteration, will answer the purposes of any audit; but there will usually be some special circumstances connected with each audit that distinguish it from others, and these circumstances will usually involve some modification of the customary routine obtaining to that class of accounts.

Some sort of definite system is undoubtedly preferable to leaving things too much in the hands of the audit clerk, as there is, in the latter case, always a danger, either of dissatisfying the client, or else of leading him to prefer a change of principals to a change of clerks, if one of the two be inevitable. For this reason, if for no other, the principal should always endeavour to keep the reins of every audit in his own hands, or, at least, out of the exclusive control of any one audit clerk; for, although objection may legitimately be taken to the latter being kept at a continual game of "General Post," it cannot be denied that it is a mistake to invariably send the same clerks to the same audits.

Before leaving the question of Audit Note-Books, attention may be directed to the following, which is employed in the office of Messrs. G. N. READ, SON & Co., F.C.A.:—

Date	Cash Balance 2/2/03	Bank Balance agreed	Cash Book Vouchers	Bought Ledger Vouchers	Petty Cash Vouchers	Dr. Cash Book Postings	Cr. Cash Book Postings
1893							
January ..							
February ..							
March ..							
April ..							
May ..							
June ..							
July ..							
August ..							
September ..							
October ..							
November ..							
December ..							
1894							
January ..							
February ..							
March ..							
April ..							
May ..							
June ..							
July ..							
August ..							
September ..							
October ..							
November ..							
December ..							

& Co.

It will be seen that the above differs from the specimens already described in much the same manner as a Ledger differs from a Journal. Instead of a separate book being employed for each audit, a folio of the Audit Note-Book is devoted to that purpose, and it will further be seen that the specimen ruling shown provides for a monthly audit extended over two years.

As this is an office book, rather than a portable one, it is written up from memorandum books, one of which is devoted to each audit, or it may be written up from the diaries of the audit clerks. In any case, however, it would seem that some sort of Audit Note-Book would require to be kept for each separate matter, in which memoranda and queries might be recorded; but it will be obvious that the information afforded by the above book would be of the greatest convenience to principals in supervising the work of their various audit clerks, and generally ascertaining the state of the various matters in hand.

THE OBJECT AND SCOPE OF AN AUDIT.—The next point to be considered is the object and extent of an audit. The object of an audit may be said to be threefold:—

- (1) THE DETECTION OF FRAUD.
- (2) THE DETECTION OF TECHNICAL ERRORS
- (3) THE DETECTION OF ERRORS OF PRINCIPLE.

On account of its intrinsic importance the detection of fraud is clearly entitled to be considered an “object” in itself, although it will be obvious that it can only be concealed by the commission of a technical error, or of an error of principle. It will be appropriate, therefore, to combine the search after fraud with search for technical and fundamental errors; but it can never be too strongly insisted that the auditor *may* find fraud concealed under *any* item that he is called upon to verify. His research for fraud should therefore be unwearying and constant.

It has been asserted by some that the whole duty of the Auditor is to ascertain the exact state of his client's affairs upon a certain given date. This is, in effect, the same thing as saying that he is only responsible for the correctness of the Balance Sheet. Even if this be the case—and it is open to considerable doubt, as the extent of an Auditor's duties depends entirely upon the terms of the express or implied contract between himself and his client—the Balance Sheet cannot well be verified without a proper examination of the Revenue Account, which in its turn involves a complete examination of the books.

The detection of fraud is a most important portion of the Auditor's duties, and there will be no disputing the contention that the Auditor who is able to detect fraud is—other things being equal—a better man than the Auditor who cannot. Auditors should, therefore, assiduously cultivate this branch of their functions—doubtless the opportunity will not for long be wanting—as it is undoubtedly a branch that their clients will most generally appreciate.

Before dealing with the various methods to be adopted to ensure the detection of errors, it will perhaps be not out of place to enquire what is the *extent* to which an Auditor is expected to carry his research. This will naturally vary according to the circumstances of each individual case; but, even allowing for this, the greatest diversity of opinion obtains, some claiming that an Auditor's duty is confined to a comparison of the Balance Sheet with the books, while others assert that it is the Auditor's duty to trace every transaction back to its first source. Between these two extremes every shade of opinion may be found; and, among others, the opinion of most practical men. Were the Auditor's functions limited to a certification that the Balance Sheet submitted to him was in accordance with the books, it would be difficult to conceive why the old-world amateur Auditor should have been found so lamentably wanting; on the other hand, it cannot be denied that (except in concerns of comparative insignificance) a minute scrutiny of *every* item would be quite

impossible to the Auditor—nor indeed is such a detailed audit often necessary, although it is in the highest degree desirable that every undertaking should possess the means of enabling the staff to make such an examination for itself.

Upon this subject the opinion of the late Mr. JOSEPH SLOCOMBE, F.C.A., will be found valuable, although it is not intended to be in any sense dogmatic. "There are some cases," said Mr. SLOCOMBE, "wherein an audit, to be efficient, should comprehend an examination of every entry in the books; there are others—more numerous—wherein the accuracy of the accounts may be verified by tests which render the checking of every posting unnecessary. Speaking generally, the Cash Book, which is in truth the root and foundation of all, should be exhaustively examined, both as to receipts and payments, and checked into the Ledgers and other books of Account under review. The whole of the postings of the Nominal and Private Ledgers should also be checked, and the nature of the entries in them scrutinised." This is, probably, as much as can be said upon the subject generally, but it raises two points which claim attention before proceeding further.

The "tests" spoken of by Mr. SLOCOMBE clearly include some sort of system by which each Ledger may be separately balanced, and its correctness thereby (presumably) verified. This is a matter that will be dealt with at some length later on, and its further consideration may be postponed until that time.

The second point is of great importance. It is in the highest degree necessary that the Auditor, before commencing his investigation, should thoroughly acquaint himself with the general system upon which the books have been kept. It is very usual for the Auditor to be supplied with a list of the books in use (by Section 7 of 42 & 43 Vict. c. 76, this is compulsory in the case of Banking Companies registered under the Act, and a similar provision is contained in the articles of association of most companies), and such a practice is, indeed,

very desirable; but it cannot be too strongly insisted that such a list can only be of any real utility when the Auditor thoroughly grasps the uses, and the possible uses (and abuses), of which each book is capable. Numerous instances have been known of an audit entirely failing through neglect of this precaution.

Having thoroughly made himself master of the system, the Auditor should look for its weakest points. "Where is fraud most likely to creep in?" he should ask himself; and, if he can find a loop-hole, let him be doubly vigilant there. But never let him for a moment suppose that, because he sees no opportunity for fraud, none can exist. To the intelligent Auditor who has grasped his system thoroughly, it is generally practicable to dispense with *some* portion of the mechanical means of checking. How much this can be done with safety must always remain a question for each Auditor's own intelligence and experience to answer, and it may be added that probably he must take the risk of any consequences that may ensue; but—so far as the matter can be dealt with in a general treatise—its solution will be sought after in these pages.

Before leaving this subject, it may, perhaps, be well to add that, under the expression "mastery of the general system," perusal of the deed of partnership, memorandum and articles of association and registered contracts, deed of settlement, special Act of Parliament, and any and all other documents that, *per se*, affect the general constitution of the concern, are included.

ADVANTAGES OF AN AUDIT.—The question has been raised from time to time as to what advantages may be reasonably expected from a proper professional audit of accounts. In addition to those mentioned in the preceding paragraph, as coming under the head of the primary objects of auditing, it may be pointed out that the proprietor or proprietors of a business will not only have the advantages of having placed before them an accurate statement of their affairs, together with a Profit and Loss Account showing how

this position has been arrived at; but that they would also have available certified accounts as to profits which cannot fail to be of the greatest convenience, either in the event of their wishing to sell the business to a private trader, or firm, or to a limited company, or in the event of one of the partners dying or wishing to retire. Under each of these circumstances the importance of a thoroughly reliable statement of profits cannot well be over-estimated, and the convenience it affords—as well as the enhanced price which can be obtained in the event of a sale—will under all normal circumstances more than compensate for any slight expense which the audit may have originally involved.

In addition it may be pointed out that various cases reported in Appendix “B” to the present work, show that in the event of an Auditor through his negligence failing to discover fraud or embezzlement on the part of the employees of the client, he may be held liable in damages for the amount lost as a result of his negligence. A complete audit conducted by a responsible firm of accountants thus virtually becomes almost as good as a guarantee policy of the honesty of all employees, and that at probably but little greater expense than such a policy would cost. This point is considered more fully later on, under the heading of “Liabilities of Auditors.”

METHOD OF AUDIT.—A comparison of the relative merits and disadvantages of COMPLETED AND CONTINUOUS AUDITS is worthy of more attention than it has hitherto attracted.

THE CONTINUOUS AUDIT sometimes includes the preparation of the final accounts by the Auditor's staff. Its advantages may be said to be: (1) The examination occurs sooner, and consequently any errors committed are more quickly detected and rectified; (2) the periodical visits of the auditor keep the bookkeeper closer up to his work; (3) a more detailed audit is practicable; (4) the audit can be completed soon after the closing of the books, without unduly

hurrying the examination. On the other hand, there is always a danger of items that have been checked by the auditor being altered (either ignorantly or fraudulently) before the final audit; and it is therefore necessary that the clerk in charge of a continuous audit be very wideawake, and have a very clear idea of the system under which he is working.

It has been found a good plan to adopt a special "tick" for the verification of all figures upon which a correction appears; as, if this plan is adopted, a correction made after the tick has been affixed will be more readily discovered. It goes without saying that the difference in the two ticks should be as slight as possible, and the bookkeeper should *not* be told what the difference implies.

THE COMPLETED AUDIT (by which is meant the audit begun after the Trial Balance has been completed) obviates this difficulty to a certain extent, and, if the books remain in the Auditor's sole custody during the duration of the audit, entirely; but the drawbacks it presents (which are, naturally, the advantages of the continuous audit) render its adoption impracticable, except in small concerns or in partial audits, unless the books can be so arranged that very little detailed checking has to be done by the Auditor.

The risks involved in leaving the books in the hands of the bookkeeper during the audit are undoubtedly very considerable; but, so long as these difficulties are not lost sight of, there is but little doubt that common-sense and a general alertness will save the Auditor from this—as well as many another—danger. Moreover, where the Auditor himself closes the books—and this will not infrequently be the case in smaller audits conducted continuously—it would be difficult for fraud on the part of the staff to altogether escape detection.

It would be well to mention here the extreme importance of *completing* each item of the audit as soon as possible after it is begun. Extensive frauds have escaped detection because

the Auditor checked the balances of a Ledger one day, and the additions of such balances on the next—some of the items having been altered in the meantime. It will be obvious that had the additions been checked on the same day as the extraction of the balances, and a note taken of the total, the fraud would have been impossible.

What may be described as the “ideal” audit is one combining the two modes of investigation just described. It is sometimes attained by the employment of two independent Auditors, one performing a continuous and the other a completed audit; but more frequently the continuous audit is done by “staff” Auditors, or by the client’s ordinary employees under a good system of internal check.

CALLING BACK POSTINGS.—Having now cleared the ground of various preliminary considerations, the manifold points arising in the course of an ordinary audit will be dealt with.

It has been seen that, in every instance, it will be necessary for at least some of the postings to be called over; and inasmuch as by that means the Auditor will at once acquaint himself with the nature of the transactions that have occurred, the calling back of such postings will form an appropriate starting point for examination. Many persons prefer to start with an examination of the Vouchers; and, if the Vouchers are rich in detail, it will frequently be desirable to take them first, but when—as is often the case—they are mostly bare receipts for so much money, it will be best to start with the postings.

It is well to commence with the posting of the Cash Book, even when all the postings are to be checked, as by this means a general idea of the business done is most quickly grasped; which is very desirable. The calling over of postings can hardly be too carefully done, and although the work is decidedly mechanical—and, consequently, somewhat monotonous—it must be most conscientiously performed. In particular, care must be taken not to pass any item already

ticked, unless it be certain that it has inadvertently been ticked in the regular course of audit; and also any items remaining unticked after the calling over is completed should receive most careful attention. Inexperienced clerks are apt to "suppose" they ought to have ticked an item, or to "suppose" they ticked such-a-one instead of such-another. Either "supposition" may cause a fraud to remain undetected, or (which will, perhaps, appeal to the youthful mind more powerfully) may keep him late at his work night after night, while the senior audit clerk hunts up and down for an error in the Trial Balance. When the error is discovered to be a mistake in the posting that was passed in calling back, it is possible that the unfortunate young junior will be even more sorry that he ever ventured to "suppose."

Where it is intended to check every posting, it is a good plan, after the cash postings have been checked, for the remaining postings to be called back from the Ledger into the Day Books, &c.; and it will probably save time, while going through the Ledgers, to check the additions and balances at the same time, and so finish each Ledger at a sitting. This method, however, is not always convenient, or even possible, and much must therefore be left to the discretion of the clerk in charge.

BAD OR AMBIGUOUS FIGURES should always receive close attention, as it not infrequently happens that they are posted as one figure, and added up as another. Corrections, too, require careful attention. Erasures should always be strictly prohibited; and where hand-made paper is used for the books, they should be keenly watched for, as a clear erasure may easily have been made. It is very important that the room used by the Auditors be well lit, or mistakes may easily occur. Where a correction has been made, care must be taken to insure that the addition and posting have also been altered; in a continuous audit this is very important, but—as it has already been noticed—it need not now be dilated on.

It may seem almost superfluous to say that the clerk calling back should always speak clearly, but experience teaches that

this is a matter that frequently does not receive the consideration it deserves. Such a mistake as £20 3s. 9d. being posted £23 9s. 0d. may be guarded against by emphasising the last syllable of the pounds, thus—"Twen-ty, three, nine." It is important that the clerk calling should learn to "pull with" the one who is turning over folios. This is a habit much more readily acquired by some juniors than others—in many respects it resembles the art of *accompanying* in music—and the senior who has found a youngster to suit him will not willingly make a change, as the economy of nervous force consequent upon perfect accord is very considerable.

CHECKING ADDITIONS.—In all cases it is desirable, although it is not always practicable, that all the additions should be checked. In every case, however, the additions of the Private Ledger, Nominal Ledger, Cash Book, Bill Books, Petty Cash Book, and Wages Book will require to be verified. This should always be done when the other work connected with the same book is being done; for, if the bookkeeper has power to make alterations meanwhile, he can afford to laugh at every safeguard against fraud.

It is hardly necessary to add that the checking of additions, though purely mechanical, is most important work. It is especially necessary that the "carried forwards" be checked on to the following page, as errors frequently occur here. Also, when checking the additions of a book with several columns of figures, it is important to see that the distinction between the various columns is preserved.

THE PREVIOUS BALANCE SHEETS.—While the junior clerk is checking additions, the senior will have time to see to many matters which require his attention. Foremost amongst these will be the comparison of the Ledgers with the last Balance Sheet—unless, indeed, the principal has already dealt with this point.

It is very generally conceded that no Auditor can be made liable for the acts and omissions of his predecessor, but,

nevertheless, he must be careful to see that he begins where his predecessor left off. This, of course, involves a careful comparison of the previous Balance Sheet with the opening Ledger Balances of the period under review. Further, no harm will be done if the Auditor satisfies himself that such Balance Sheet is, *prima facie*, a fair statement of assets and liabilities. He must also be particularly careful how he uses the figures of the last Balance Sheet for Plant, Share Capital, Debentures, &c., where no alteration (save Depreciation in the case of assets) has occurred during the year. Most likely, in adopting such figures of the previous Auditor, the present Auditor would be held to have himself certified them, and he could probably make no good defence by saying that he took the amounts from the previous account.

VOUCHERS.—Much might be written, and, indeed, has been written, upon the important subject of Vouchers: it is, however, impossible to treat the matter exhaustively in the space at disposal. A paper by Mr. HOWARD S. SMITH, F.C.A., upon the subject was reproduced in *The Accountant* of 14th January 1888, which may be consulted with advantage.

The present work would, however, be incomplete without some mention of the matter, which, for convenience sake, will be dealt with under the following heads:—

- (a) Receipts.
- (b) General Payments.
- (c) Petty Cash.
- (d) Wages.
- (e) Bank Account, &c.

Each of these involves, for its complete consideration, the question as to the form of accounts employed, but the relative merits of the various forms available will mostly be more conveniently dealt with at a later period.

(a) **RECEIPTS.**—It is part of the Auditor's duty to ascertain, as far as possible, that all cash received has been

entered to the debit of the Cash Book. The usual mode of verification available will be a comparison of the counterfoils of the Receipt Books with the Cash Book entries. Counterfoils should always be numbered, and the bookkeeper should mark the Cash Book entry with the number of the receipt. It is necessary that the Auditor should notice that the numbers of the counterfoils run consecutively, and if there are any numbers missing, or any counterfoils left blank, a satisfactory explanation must be found. If a receipt has been cancelled, the body should remain attached to the counterfoil; for it need hardly be pointed out that this is much more satisfactory than any other explanation possible. The receipt for two accounts paid together should be acknowledged on two separate forms. If there be no hard and fast rule, there is nothing to prevent the collector from using separate counterfoils while only using one receipt, which, of course, leaves him an extra receipt form to use for another acknowledgment which he need not account for. Defalcations have frequently arisen, or remained undetected, from a neglect of this precaution.

On the other hand, there are some cases where it may prove better to *forbid* the use of two receipts for two payments made the same day. This course, however, leaves it open to the collector to account for the two payments on different days, and so gain possession of a blank form. In either case, the special point is that there should be one fixed rule, which should be rigidly maintained. But, whatever precautions be taken, the method is by no means infallible, and in consequence many Accountants have advocated the issue of a circular to all customers, requesting a verification of their respective accounts as quoted. This method is, of course, quite impracticable with a retail business, but among wholesale houses would probably prove a valuable precaution. As a rule, however, wholesale accounts are run upon certain known terms as to credit, so that any irregularity would be apparent to the observant Auditor. In any case the Auditor must not communicate with his client's customers on his own responsibility.

It has, unfortunately, become the custom of many large firms to send their own form of receipt with remittances, and the efficacy of counterfoil Receipt Books is thereby much impaired. So far as possible, the Auditor should ascertain what firms do adopt this practice—and here he will, perhaps, find the knowledge gained at one audit may help him to detect something wrong at another.

Dividends and compositions in Bankruptcies, &c., will inevitably have been accompanied by a special form of receipt; if, therefore, such entries be found upon a receipt counterfoil, the circumstance may well give rise to suspicion.

The dates of the counterfoils should always be compared with the Cash Book entries.

Cash Sales require very careful scrutiny, and the method of internal check adopted should always be ascertained, and, as far as possible, perfected. Where practicable, it is most desirable that the clerk who writes up the Cash Book should *not* be the one who receives the money.

Special items of receipt will be more conveniently dealt with when considering the audit of various kinds of accounts.

(b) GENERAL PAYMENTS, other than those for wages and petty cash, should invariably be made by cheque, payable to "order," and crossed. Even where the amount is only a few shillings this method of payment will, in the vast majority of cases, be simpler, as well as safer, than cash payments. Such payments by cheque hardly require vouching, but it should nevertheless be done, nor will the process be difficult. Receipts can readily be obtained for all ordinary payments, which should be numbered consecutively (the numbers of the cheques are very useful for this purpose sometimes), as should also the items in the Cash Book.

A receipt on a firm's own printed form is very much better evidence that they have received the amount stated, than a receipt on the form of the payer, although, doubtless, a uniform

form of voucher will save the Auditor's time slightly. From both points of view, it is not desirable that *payers* should provide their own form of receipt; be this as it may, however, the practice exists, and will probably continue to do so.

Some special payments cannot be vouched in the usual way (*e.g.*, insurance premiums on a new policy), but satisfactory evidence that the payment was actually made, and value received, should always be obtained. An auditor whose practice is mostly in one particular industry will soon get to know the signatures of most trade houses; and, doubtless, this knowledge might often prove valuable; for, although any clerk is frequently deputed to acknowledge receipts, yet the endorsement of the cheques will usually be done by one hand alone.

(c) PETTY CASH.—Whatever system of petty cash be adopted, the vouching of petty cash, as a whole, will be the only possible real verification of the payments made from cash to petty cash, and the whole matter may be appropriately considered here. The actual inspection of petty cash vouchers may, or may not, be undertaken by the Auditor, as he thinks fit. In the latter case, a responsible person must certify the whole of the items *en bloc*; and in the former case, a similar person must pass each separate voucher. Important frauds are hardly likely to occur in petty cash; but, as likely as not, petty peculations will arise, if an efficient supervision be not exercised. No Auditor can properly supervise the petty cashier, and it is well to acknowledge the fact fully; he may, however, see that every payment has been duly authorised by the responsible head, that the payments made by the cashier have been duly acknowledged, that the additions of the Petty Cash Book are correct, and that the balance unspent is in hand. Beyond this he should not attempt to go.

Some clients have a very bad habit of making comparatively large payments through petty cash. This should be discouraged as far as possible. Some have a still worse habit of allowing the petty cashier to *receive* small amounts; this is a

very bad system, and should be most vigorously contested. All receipts should be banked, no matter how trifling in amount, and a clerk in charge of cash receipts should never be in charge of cash payments.

(d) WAGES.—Instances of fraud in the payment of wages are among the most frequent of those that come under the notice of an Auditor; but, from the very nature of the case, direct evidence of proper payment is all but impossible. Signatures might, and frequently are, required from each man receiving wages; but many men can only sign by means of affixing their "mark," while many others would not be above "going shares" with the paying clerk in anything they could get over their due. Circumstantial evidence is thus the best available for the Auditor, and this will consist in a good *system* of payment, which renders fraud improbable by reason of the number of persons concerned in the preparation of the pay-sheet and the subsequent payment. Particulars of time worked, or piece-work done, should be certified by the foremen; the calculations of wages done by one office clerk, and checked by another, the cash for the wages made up by the cashier, and the wages paid by him or his deputy in the presence of a works manager. Where possible, a cheque should always be drawn for the exact amount of wages required. The Auditor should always enquire as to the particular system adopted, and should ascertain that it is really carried out; sometimes it might be well for him to unexpectedly put in an appearance when the wages were being paid. The Wages Book should always be added, and a week or two's wages should be taken at random, and checked up and down.

(e) BANK ACCOUNT, &c.—All payments into the Bank should be checked off by the Pass Book. The composition of a few such payments (as shown by the counterfoil slip book) may be advantageously compared with the items which they purport to represent, and any irregularity carefully followed up; the credit side of the Cash Book should also be checked off against the Pass Book, and any disagreement of the *names*

should receive careful attention. The Bank Balance must, of course, be verified, and if the Auditor has not himself received the Pass Book from the Bank, he should make a point of either obtaining the Bank's certificate as to the balance standing on the date of the account, or of taking it back there, in *person*, or he will run the risk of never having seen the *real* Pass Book at all. If there be a balance of cash in hand it must be verified, and the Auditor should ascertain that it has not been made good by means of a cheque *drawn since the books were closed*. This is a point that deservedly received attention in Mr. G. P. NORTON's admirable paper on "THE AUDIT OF A MANUFACTURER'S ACCOUNTS" (*vide The Accountant*, 15th November 1890), where the matter is dealt with at greater length than has been thought necessary here.

In a continuous audit, the vouching should always be kept as close up to date as possible, while the Bank and Cash Balances should be verified at every visit. A Cash Balance will sometimes be found to consist largely of "I.O.U.'s"; this should always be discouraged as far as possible, and it may be necessary to call the attention of the chief to its undesirable preponderance.

With regard to the actual marks an Auditor should make when vouching, individual opinion will doubtless generally be the Auditor's guide. The author considers the best plan is to clearly cancel the voucher by means of a large tick, right across its face, and to mark a distinct "V" against the item in the books, those items that are vouched from sources other than vouchers proper being initialled by the Auditor. Many accountants, however, prefer to initial all vouchers.

Where the Auditor suspects irregularities that he is unable actually to detect, he may frequently gain his point by *feigning laxity* in his method of vouching; this will often serve to induce that carelessness on the part of the defaulter that is necessary for his detection and exposure. The author, who has had a considerable experience of frauds of all kinds, has found this method work admirably; it is, however, necessary that it be practised with discretion.

BILLS OF EXCHANGE.—A few words on the subject of Bills will not be out of place.

BILLS PAYABLE will present but little difficulty; the returned draft forms, of course, the voucher for the payment of Bills matured, while the Bills running (as shown by the Bills Payable Book) will explain the balance of the Bills Payable Account in the Ledger.

BILLS RECEIVABLE require more careful consideration. The Bills Receivable Book should be dealt with *seriatim*; all Bills matured or discounted should be traced into the Cash Book, and, if dishonoured, back to the debit of the customer; all Bills dishonoured, or still running and undiscounted, should be in hand, and this fact must be verified.

Discount deducted from Bills discounted should be looked into to a certain extent, although not necessarily exhaustively; also, the important questions of the liability upon Bills under discount, and the value of Bills dishonoured, must not be lost sight of. Both these points require to be considered when the provision for bad and doubtful debts is dealt with.

Dishonoured Bills should never be allowed to remain on the Bills Receivable Account of the Ledger.

CONSIGNMENTS.—It is very desirable that all points connected with consignments be checked up and down as much as possible; and for this purpose letter-files, copy letter-books, and accounts current should be fully consulted. There is, however, nothing particular in the nature of the transactions (save the question of foreign currency, which is dealt with elsewhere) that calls for especial comment here. The best system of recording them is dealt with later on.

THE TRIAL BALANCE.—It should be the Auditor's aim, so far as possible, to carry each department of his investigation right up to the Trial Balance at the same sitting. Of course, in an important audit, this can very rarely be accomplished; but the Auditor must always remember that there is material danger in leaving any portion unfinished in the hands

of bookkeepers or cashiers, who—for all he can know to the contrary—may manipulate the figures during the course of the audit.

The Auditor, therefore, should endeavour to fix everything up as he goes along, and where he cannot finish the same day, he will do well to keep possession of the books and documents until he can. In fact, he should, so far as possible, keep everything in his own hands until the audit is completed as far as the Trial Balance. Having once secured a Trial Balance that he knows has not been tampered with, the Auditor may cease to trouble himself about the materials from which it was built up—they may be manipulated and altered up and down, but he holds in his own hand the key of the whole position. Nor need the course indicated cause offence, or even excite suspicion, if carried out with tact. It is generally an easy matter to hang on to a list of balances, and not often difficult to “take home” a book so as to get it finished. And, even where this cannot be accomplished unostentatiously, a few notes and private marks will often serve the purpose. It is not a difficult matter to acquire a “tick,” which, while looking much the same as any other, can be instantly distinguished from a forgery. A man forging ticks will be much less careful as to their form than a man forging initials, and can thus be more often detected. It is not a bad plan to carry about one’s own coloured ink, and to take care that it is a different make from that in general use at the offices where the audit is conducted. The Auditor, however, must be careful not to talk about these things; and he should also be careful not to leave his ink about. It is often a great advantage to employ ink of a different colour to that used at the preceding audit.

BALANCING.—In the foregoing paragraph it has been assumed that an exact balance has been arrived at by the bookkeeper before the Auditor commences his investigation. This, of course, is as it should be, for clearly it is no part of the Auditor’s duties to balance the books. The question arises, however, as to whether an Auditor is ever justified in passing accounts that do not exactly balance. Obviously,

accounts that do not balance cannot, in the nature of things, be entirely accurate; but so long as the Auditor is satisfied that the discrepancy arises from one error, and not from the combined effect of numerous errors, and so long as the difference is so small as to have no practical effect upon the ultimate result, the absence of an accurate balance may sometimes be disregarded. Here, as elsewhere, however, much depends upon circumstances: a Nominal or Private Ledger—or, indeed, any Ledger with less than, say, 500 accounts—ought certainly to balance exactly; on the other hand, it is hardly practicable to ensure an absolute balance with a large Trade Ledger—hence the importance of these balances being tested at frequent intervals, say monthly at least.

METHODS OF BALANCING.—In private audits it not infrequently happens that the Auditor is requested to balance the books. The detection of errors in balancing is thus a matter with which an Auditor occasionally has to deal, although it does not in any sense form part of the actual audit itself.

There are two modes of seeking for errors in balancing:—

- I. By localising the error.
- II. By tabulating the Ledger Accounts.

LOCALISING THE ERROR.—This is, of course, best accomplished by framing the system of accounts upon such lines that each separate Ledger is “self-balancing.” Where this has been done, it is a very simple matter to see in which Ledger or Ledgers the discrepancy arises, and the field is at once narrowed accordingly. It may easily happen, however, that the various Ledgers have not been framed upon self-balancing principles; even then it does not necessarily follow that the error cannot be localised. If the Cash Book be in tabular form, or if there be separate subsidiary Cash Books, the equivalent of an Adjustment Account can almost always be constructed; transfers from one Ledger to another may complicate matters, but unless such transfers are much

more numerous than is usual, they will hardly present any very serious difficulty. On the other hand, it is not often practicable to apply this method if it necessitates an analysis of the Cash Book.

TABULATING THE LEDGERS.—This is a method which is sometimes adopted where the number of Ledger Accounts is not large, and, where practicable, it is extremely thorough. It consists of making an abstract of every Ledger Account upon sheets, which are virtually Tabular Ledgers. When the abstract has been completed the checking of the cross additions proves the extraction of the Ledger balances, while a comparison of the longitudinal totals with the opening balances, Day Book totals, total of cash received, &c., will show in which direction the error lies. Thus, if the total "Goods Sold" does not agree with the total "Sales Account" in the Nominal Ledger, there is clearly an error in the postings or the additions of the Day Books. Many accountants, however, and among them the present author, prefer to carefully re-check the Ledger item for item, rather than adopt such a laborious process of localising the error—especially when it is remembered that even when the abstraction of the Ledger has been completed, the localisation has been directed, not to one Ledger Account, but to one subsidiary book.

From the author's point of view, the chief value of the tabulation of the Ledgers is in the event of it being necessary to convert books previously kept upon single entry into double entry: this is a feat which is sometimes necessary when examining the books of an undertaking about to be converted into a limited company, or when endeavouring to frame a Deficiency Account in cases of insolvency.

Mr. J. G. CRAGGS, F.C.A., has published an explanatory handbook, dealing with a system of balancing by tabulation of the Ledgers which is in use in his office. The full title of the work will be found in Appendix "D." Shortly stated, the speciality of the system is that the tabulation is an integral part of the calling back of the postings, and is said not to add

to the time required for that work alone. Where a large set of books have to be balanced *en bloc*, Mr. CRAGGS' system would certainly appear to be worth a trial: the author cannot, however, speak from experience as to its efficacy.

AUDIT OF JOINT STOCK COMPANIES.—The chief points arising in the course of the audit of a Joint Stock Company that do not occur in the audit of a private firm may be divided under the following heads:—

- (a) The audit of Share Capital and Debenture Accounts.
- (b) The audit of Dividend and Interest Accounts.
- (c) Compliance with the various statutory requirements.
- (d) Compliance with the Memorandum and Articles of Association, Special Acts of Parliament, or Deed of Settlement.

(a) **THE AUDIT OF SHARE CAPITAL ACCOUNTS.**—The main points are: (1) Does the stated amount of issued capital represent a valid allotment to *bonâ fide* applicants? To ascertain this, the Auditor must see that the amount is within the authorised issue, that the various classes of shares (if there be classes) are in accordance with the memorandum of association and prospectus, that the minutes of allotment are in order, that the allottees have agreed to become shareholders to an extent not less than the amount of their respective allotments, that the aggregate number of shares actually issued to the various allottees is equal to the total number stated to have been issued. (2) Has the amount stated to have been paid up been actually received in cash, or else in kind under a valid contract duly registered previous to allotment in accordance with the requirements of section 25 of the Companies Act 1867? This requires the Auditor to satisfy himself that the minutes making calls are in order, that the amount said to be paid up has actually been received by the bank (application and allotment money and calls should always be paid to the bankers direct), that a valid contract has been registered for all shares issued as paid up, that shares liable to forfeiture,

but not forfeited, appear—so far as can possibly be known—to have been issued to *bondâ fide* existent persons. Premiums received on the issue of shares should be credited to Reserve Fund. Shares cannot legally be issued at a discount.

At subsequent audits it should be ascertained that the Share Ledgers balance; the author never heard it contended that a *full* examination of the Share Ledger was part of an ordinary audit.

So far as the above remarks apply, they will serve to indicate the Auditor's duties with regard to STOCK or DEBENTURES, save that debentures may be issued at a discount.

(b) THE AUDIT OF PAYMENTS FOR DIVIDEND AND INTEREST is not usually a difficult matter. A list of Shareholders should be handed to the Auditor, showing the number of shares held by each member on the day the dividend was declared, and the amount of dividend due. The additions of this list should be checked, and the totals agreed with the amounts of Shares issued and Dividends payable respectively: it must also be seen that the rate of dividend is correctly calculated *in toto*. In the case of interest on debentures, Income Tax must have been deducted, as also in the case of dividends on shares, unless, indeed, the dividend be on Ordinary Shares and has been declared "free of Income Tax." A few of the larger amounts, taken at random, may be advantageously compared with the Share Ledger, but it is not generally essential that the whole list be exhaustively checked. Many large concerns draw one check for the whole amount of the dividend, and pay it into a separate banking account, against which the dividend warrants are issued. Where this method is adopted, it is a comparatively simple matter to vouch the payments and verify the amount of outstanding dividends—which latter will, of course, agree with the balance of the Pass Book. Where dividends are paid in cash, or by cheque upon the ordinary banking account, the vouching becomes merged in the vouching of the general payments. The outstanding dividends will not be so easily traced,

but will present no special difficulty that requires particular mention here.

Interest on debentures, &c., presents no further points for consideration; but it is particularly necessary to bear in mind that Income Tax must always be deducted from interest, and from (maximum) dividends on preference shares, or the ordinary shareholders will suffer an injustice.

(c) THE VARIOUS STATUTORY REQUIREMENTS, above referred to, together with the several sections enforcing their use, are as follows:—

So far as companies registered under the Companies Acts 1862-1898 are concerned:—

- (a) Register of Members (*vide* section 25 of the 1862 Act).
- (b) Register of Mortgages (*vide* section 43).
- (c) Annual List of Members and Summary Book (*vide* section 26).
- (d) Minute Book (*vide* section 67).

And, in the case of companies limited by guarantee:—

- (e) Register of Directors and Managers (*vide* section 45).

Companies incorporating the Companies Clauses Act 1845—that is to say, almost all companies incorporated by special Act of Parliament—are required to keep the following:—

- (a) Register of Shareholders (section 9).
- (b) Shareholders' Address Book (section 12).
- (c) Register of Holders of Consolidated Stock (section 63).
- (d) Register of Mortgages (section 43).
- (e) Registers of Transfers (section 15).
- (f) Minute Book (section 98).

The particulars required to be contained in each of these books may be ascertained upon reference to the sections named, which are reproduced in full in Appendix "A."

In the case of all companies the following statistical books are practically indispensable, whether required by statute or not :—

Shareholders' and Debenture-holders' Address Books.

Share Ledger.

Debenture Ledger.

Transfer Registers (for Shares and Debentures).

Directors' Attendance Book.

Applications and Allotments Book (one for each class of shares or debentures).

Call Books (ditto).

Agenda Book.

Strictly speaking, there is nothing to audit in these various books—because they are statistical books merely, and not books of account—but the Auditor should satisfy himself that the records are kept in the prescribed form, and, *prima facie*, correctly. In addition, he will do well to ascertain that all mortgages and charges have been entered fully in the Register of Mortgages.

(d) COMPLIANCE WITH THE MEMORANDUM AND ARTICLES OF ASSOCIATION, SPECIAL ACTS OF PARLIAMENT, OR DEED OF SETTLEMENT.—Under this heading it is difficult to profitably draw attention to any specific points. It may be mentioned, however, that it is not merely expedient, but also absolutely necessary, that the Auditor should carefully peruse such of these documents as may relate to any particular audit, with a view to modifying his course of action accordingly. The special points to which it will be necessary for him to direct attention are, so far as the capital is concerned, as to whether it has been duly authorised; so far as the accounts are concerned, that any special points raised in these documents are borne in mind when considering the method upon which the accounts have been framed; and, so far as the question of profits available

for dividend is concerned, as to whether all stipulations as to certain profits being carried to reserve, or applied to the future redemption of debentures, have been properly dealt with.

In the case of companies registered under the Companies Acts, it is also desirable that particular attention should be directed to the various contracts connected with the original formation of the company. In all cases the prospectus should be very carefully scanned, with a view to seeing that any special provisions laid down therein are also included in the regulations of the company, and have been acted upon. It is naturally difficult, if not actually impossible, to speak exhaustively in this connection; but it may be mentioned that, supposing a prospectus states that the directors will not take any fees unless the company has made profits, or until a certain dividend has been paid to shareholders, then, whether or not a similar provision is contained in the company's Articles of Association or special Act of Parliament, it is necessary that the Auditor should see it has been complied with in the accounts which come before him for certification. At this point, however, nothing more than general hints can be given.

CHAPTER II.

METHODS OF ACCOUNT

(Suggested in the Course of Audit.)

It is not strictly any part of the Auditor's duty to offer suggestions or issue instructions as to the system of accounts to be adopted, but on account of his experience in such matters he is frequently asked to do so. The following remarks will, therefore, not be amiss in the present connection; but it will, of course, be understood that the various questions now about to be considered are, for the most part, largely matters of individual opinion. The views stated in the following paragraphs are but those of the author, and it is by no means suggested that they should be unquestioningly taken on trust by the readers of this book. Circumstances notoriously alter cases, and in no state of existence is this more true than in the realm of accounts. With a view, therefore, to giving the following opinions a more practical value, the author has endeavoured, in all debatable cases, not only to state reasons, but also to cite some recognised authority in support of the views laid down. It has not generally been thought necessary to quote all that has been said upon the other side; but in some cases it has been deemed advisable to place both sides of the question fully before the reader.

The above remarks will serve to explain the *modus operandi*, not only with regard to the forms of accounts suggested here below, but also in the following chapters, where various important questions of principle are considered.

GENERAL SYSTEM OF INTERNAL CHECK.—This is a matter that may very profitably engage the careful attention of the Auditor, for not only will a proper system of internal check frequently obviate the necessity of a detailed audit, but it further possesses the important advantage of causing any irregularities to be corrected *at once*, instead of continuing until the next visit of the Auditor, which—even in the case of a continuous audit—is clearly a consideration. It is very probable that the Auditor will be asked to make any suggestions that may occur to him for the improvement of the existing system of accounts, or in the case of a new undertaking he may be invited to prepare a system for the use of his clients. In the latter case at least the work is naturally no part of the regular audit, and should command a special fee, and even in the former case it would not usually be regarded as an extra unless the alterations suggested and adopted were of a very radical nature.

In devising any system of internal check, there are three matters to be specially borne in mind: first, the person in charge of the cash should never be in charge of any Ledger, or, at least, of any Trade Ledger; secondly, each separate Ledger should be made self-balancing, or at least should be so arranged that it can be separately balanced, and where this is for any reason not altogether practicable, it is absolutely essential that those Ledgers which are not checked in detail should be so arranged that they may be collectively balanced separately from those Ledgers that are; thirdly, where the Trade Ledgers are numerous and are not checked in detail, the clerks in charge should be frequently changed about, so that if there is any irregularity it is impossible for it to remain long undetected without implicating the whole staff. With a system of accounts arranged upon these lines, a detailed audit is frequently unnecessary, but it is always desirable that the Auditor should satisfy himself that the system has actually been carried out in its entirety, and sections of the work should be fully checked at unexpected times.

INSTRUCTIONS AS TO GENERAL SYSTEM OF ACCOUNTS.—It is usually desirable that the head book-

keeper should be placed in possession of written instructions containing an outline of the system to be followed. These written instructions would naturally vary very considerably according to circumstances, and it is impossible to give here more than the barest outline of what might be required. The following points are, however, important ones, which will generally require to be included :—

(1) All cash received to be paid into bank daily. The cashier to have no control over any of the Ledgers.

(2) All payments other than petty cash payments to be made by cheque, whatever the amount.

(3) The Petty Cash Book to be kept upon the imprest system under the supervision of the cashier. The clerk in charge of the petty cash must on no account be allowed to receive any moneys for sundry cash receipts.

(4) Counterfoil Receipt Books to be used for all moneys received, and vouchers obtained for every payment.

(5) The cash and bank balances to be verified weekly, or oftener, and the adjustments recorded in a special Balance Book.

(6) All Ledgers to be rendered self-balancing, and all Trade Ledgers to be balanced monthly. A maximum difference of rs. to be allowed in any one Trade Ledger, subject to the approval of the head bookkeeper. All such differences to be recorded from time to time in a special book kept by the head bookkeeper.

(7) An adequate system of Stock Accounts and Cost Accounts to be provided.

(8) All invoices for purchases to be passed by the Goods Received Department, by the Buyer of the Department concerned, and by the Counting-House, before being entered in the Purchases Book.

(9) Statements for trade payments to be passed by some responsible person, preferably one of the partners, or—in the case of a company—the managing director.

(10) The calculations of all sales invoices to be checked in the Counting-House before the Sales Ledgers are posted.

(11) Each time the Sold Ledgers are balanced a list of all accounts more than —— days overdue to be submitted to the head bookkeeper, and by him to one of the principals for further instructions.

(12) A thoroughly efficient system of calculating and paying wages to be introduced, and closely adhered to.

In the case of a company :—

(13) The Minute Books to be fully entered up, and kept indexed to date.

(14) All exceptional transactions to be reported to the Board at the next meeting for approval or further instructions.

(15) The various books required by the Companies Acts to be kept written up, and the necessary returns to be made to the Registrar from time to time.

COST ACCOUNTS.—Every system of bookkeeping, worthy of the name, that purports to record the transactions of a manufacturer, will provide some method of ascertaining the cost of the articles produced, while many systems recording transactions of a purely trading nature (*i.e.*, buying and selling *only*) will likewise find a proper system of costing most advantageous. The fact remains, however, that Cost Accounts, as now generally arranged, are unsystematic, unreliable, and unaudited.

It is not proposed to devote any large portion of space to the advocacy of the proper system of costing. Those who doubt its utility will do well to study a paper on the subject by Mr. JOHN MANN, Junr., M.A., C.A. (Glasgow), which appeared in *The Accountant* of 29th August and 5th September 1891, and also a leading article that appeared in the issue of

that paper for the 28th November 1891, and many others which have appeared in those columns more recently. If these contributions have produced no effect, the author doubts his ability to work a conversion, and must, therefore, be content to pass the matter by.

On account of the extreme paucity of literature upon the subject of costing when this work first appeared, it was thought desirable to call attention to the leading principles that should underlie every system. A good deal of valuable matter has, however, since appeared in the columns of *The Accountant* and elsewhere, but it has been thought well to retain the following sketch of the system in these pages notwithstanding. More than general principles cannot be attempted there, as the details will of necessity vary greatly in every different class of business.

It must be pointed out, however, that the Accountant who is entirely without practical knowledge of the business carried on cannot expect to be able to intelligently apply these general principles to a particular case.

Taking first the case of a manufacturing, or producing, business—say, a builder. Each contract will require a special heading in the Cost Book; to this heading all wages paid for time booked on the job will require to be charged. For this purpose proceed as follows:—

WAGES.—Post cash payment of wages to the debit of Wages Account in General Ledger, analyse wages into various contracts, debit the various contracts in Cost Book, and credit a General Ledger Account in same with total; at the end of year, or half-year, debit a Cost Ledger Account in General Ledger, and credit Wages Account with total of wages charged up. Wages Account will then balance, unless there are some wages due (as, most likely, there will be), the debtor balance of Cost Ledger Account in General Ledger will agree with the General Ledger Account *credit* balance in the Cost Book, while the Cost Book, being itself kept on a double entry system, will balance its own debits and credits.

Goods or materials may be divided into two classes:—

(1) SPECIAL MATERIALS, bought for particular contracts ;
(2) GENERAL MATERIALS, bought for Stores. Special materials are booked direct to the debit of the job in Cost Book, and credited to General Ledger Account therein. In the General Ledger they are credited to the merchant supplying them, and debited to a "Special Stores (or some equivalent) Account," the balance of the latter being transferred to the debit of Cost Ledger Account at balancing time, so that the latter still agrees with the General Ledger Account of the Cost Book. General Materials are debited to Stores Account, and credited to the merchant in the General Ledger. An accurate account is kept of all Stores issued for each job. Once a week, or once a fortnight, the analysis of Stores issued is debited to the various contracts, and the total credited to General Ledger Account in the Cost Book. The same total is debited to Cost Ledger Account, and credited to Stores Account in the General Ledger, so that the balance of the former will still agree with the balance of the General Ledger Account in the Cost Book. The debit balance remaining on the Stores Account will represent the Stores still on hand, and should agree with the result of the stocktaking. So far, the effect of the records has been to divide the expenditure for Wages, Special Stores, and General Stores issued, among the various contracts, in due proportion ; it only remains, therefore, to load each contract with its due share of expenses.

DIRECT EXPENSES, or expenses of production, consist of superintendence, and expenses connected with occupying, repairing, and renewing Works and Plant. A proper division of Nominal Accounts will readily furnish the Accountant with the amount of Direct Expenses during the period ; the question is how to apportion them ? The soundest method will be to divide the Direct Expenses among the various contracts in proportion to the number of hours booked upon each. The necessary entries in the books will be similar to those already indicated

INDIRECT EXPENSES (in the case now dealt with probably limited to financial and office expenses and bad debts) may, on the other hand, be more properly taken as varying with the turnover, and should be divided accordingly.

The whole of the cost has now been charged to the various Contracts. The amount of each Contract will have been debited to the various customers, and credited to Contracts Account. Now debit Contracts Account, and credit Cost Ledger Account in the General Ledger with the total amount of contracts; the credit balance of the Cost Ledger Account will then show the net profit. Turning to the Cost Book, credit each contract with the amount receivable, and debit General Ledger Account with same. The sum of the various contract credit balances will agree with General Ledger Account debit balance, which will agree with the credit balance of Cost Ledger Account in the General Ledger, which is the net profit.

It will be seen that this system, while thoroughly verifying its own accuracy, in no way interferes with the preparation of the ordinary Trading Account, which should always be prepared, so that the amount of the turnover may be seen.

The amount of labour involved in a good system of costing is by no means great. The most troublesome item is the General Stores; but this would be required in any case, as will be seen later on.

A more detailed exposition of the method of keeping Cost Accounts will be found in Part III. of the author's *Bookkeeping for Accountant Students*, which deals with a system of Cost Accounts suitable for a contractor or engineer. It has been thought desirable, however, to include in this edition *pro formâ* cost sheets relating to various classes of industries from which others suitable to almost any conceivable undertaking can be readily deduced. These are as follows:—

Dr.

FOR IRON FOUNDERS, STEEL MANUFACTURERS, &c.

COST OF MANUFACTURE.

Tons Cwts. Qrs. lbs.

Make 639 13 1 12

	Weight				Average price per ton			Amount			Cost per ton			Consumption of materials per ton of iron		
	Ts.	cts.	qs.	lbs.	£	s	d	£	s	d	£	s	d	Ts.	cts.	qs. lbs.
To Puddled Bars ..	316	9	3	0	3	5	7	1,037	8	10	1	12	5.25	9	3	16
" Scrap Iron ..	413	11	0	14	2	11	0	1,054	2	4	1	12	11.25	12	3	11
" Coal ..	730	0	3	14	—			2,091	11	2	3	5	4.30	1	2	3 9
	564	18	0	0	7	8		214	5	5		6	8.40	17	2	18
Firebricks, Clay, and Sand ..	..	..	..	..	..	..	..	33	3	4	1	0.44				
" Stores ..	..	..	..	..	..	..	..	57	8	11	1	9.55				
" Repairs—Materials ..	..	..	..	..	..	..	..	41	15	2	1	3.67				
" Do. Labour ..	..	..	..	..	..	..	..	22	5	10		8.36				
" Trade Charges ..	..	..	..	..	..	..	..	32	12	8	1	0.24				
" Rent, Rates, and Taxes..	..	..	..	..	..	..	..	54	18	6	1	8.60				
" Gas and Water ..	..	..	..	..	..	..	..	10	17	6		4.08				
" Office Expenses ..	..	..	..	..	..	..	..	31	13	6		11.90				
" Wages and Salaries ..	..	..	..	..	..	..	..	467	11	4	14	7.43				
" Total Cost ..	..	..	..	..	..	..	..	£3,058	3	4	4	15	7.17			
" Balance, being Profit (carried to Profit and Loss Account) ..	..	..	..	..	..	..	..	249	8	8	7	9.85				
								£3,307	12	0	£5	3	5.02			

	Ts.	cts.	qs.	lbs.	£	s	d	Value per ton.
By Bar Iron	646	14	1	21	3,593	2	9	
Less								
Discounts and Allowances	6	1	0	9				
Carriage, Freight, &c.								
Commission								
	6	1	0	9	307	14	10	
	640	13	1	12	3,285	7	11	5 2 6'77
Deduct								
Decrease in Stock of Bar Iron :—								
Stock at 1 Jan. 1892	19	0	0	0				
Do. 31 July 1892	18	0	0	0				
	1	0	0	0	14	10	0	
					3,270	17	11	5 2 3'22
					36	14	1	—
By Mill Cinder Scale, &c. .. 145 tons 10 cwt.								
Total make and value of same	639	13	1	12	£3,307	12	0	£5 3 5'02

FOR GAS COMPANIES.

— GAS COMPANY.

WORKING STATEMENT for the year ended — 19 —.

Gas made, as per Station Meter	..	..	..	..	..	Cubic Feet
Gas sold: Private Lighting	..	..	..	..	137,963.400	156,288,000
Public Lighting	..	..	..	..	10,953.450	148,916,850 or 95.28 per cent. on make.
						7,371,150
Gas used on Works and Offices, as per Meters	..	..	..	..	..	2,500,000 or 1.60 do.
Gas unaccounted for	..	..	..	..	..	4,871,150 or 3.12 do.
						100.00
Capital employed	..	..	..	..	..	..
Do. per Ton of Coal Carbonised	..	..	..	..	..	..
Do. per 1,000 cubic feet of Gas sold	..	..	..	..	..	..
Coal Carbonised, Common	..	..	..	..	..	14,117 Tons or 97.62 per cent.
Cannel	..	..	..	..	..	344 " 2.38 "
						100.00
						14,461 100.00
Gas made per Ton of Coal Carbonised	..	..	..	..	..	..
Gas sold per ton of Coal Carbonised	..	..	..	..	..	..
Coke made	..	..	..	..	..	..
Coke made per Ton of Coal Carbonised	..	..	..	..	..	..
Coke used for Fuel per cent. on make	..	..	..	..	..	..
Tar made	..	..	..	..	..	..
Tar made per Ton of Coal Carbonised	..	..	..	..	..	..
Liquor made	..	..	..	..	..	..
Liquor made per Ton of Coal Carbonised	..	..	..	..	..	..
Net Average Price realised for Coke sold	..	..	..	..	..	..
Do. Breeze sold	..	..	..	..	..	..
Do. Tar sold	..	..	..	..	..	..
Do. Liquor sold	..	..	..	..	..	..
Net Proceeds of Coke and other Residuals per cent. on cost of Coal	..	..	..	..	..	..

AUDITING.

					Per Ton of Coal Carbonised				Per 1,000 Cubic Feet Sold	
	£	s	d	£	s	d	£	s	pence	Pence
Coal	8,791	0	11	..	..	..	14'17
Less Residuals—Coke	4,653	0	4	..	..	7'47	..
Breeze	118	6	0	..	..	0'19	..
Tar	1,002	10	3	..	..	1'62	..
Liquor	692	3	0	..	..	1'11	..
Total Residuals	6,445	19	7	..	8	10'98	10'39
Net for Coal	2,345	1	4	..	3	2'92	3'78
Purifying	443	7	11	..	..	0'71	..
Salaries of Engineers	350	0	0	..	..	0'56	..
Wages and Gratuities at Works	1,436	0	11	..	..	2'31	..
	3,816	7	6	..	..	6'15	..
	341	0	0	..	..	0'55	..
	115	7	3	..	..	0'19	..
	687	10	6	..	..	1'11	..
	558	17	10	..	..	0'90	..
	738	16	3	..	..	1'19	..
	480	0	0	..	..	0'68	..
	144	5	0	..	..	0'24	..
	400	0	0	..	..	0'65	..
	119	11	8	..	..	0'19	..
	170	14	7	..	..	0'28	..
	31	10	0	..	..	0'52	..
	60	8	11	..	..	0'10	..
	80	8	5	..	..	0'63	..
Total Working Expenses	9,348	0	9	..	13	7'60	15'89
Coal and Working Expenses, less Residuals	17,245	8	6	..	..	..	19'67
Sale of Gas	1,848	13	3	..	16	10'52	..
Private Lighting	19,094	1	9	..	..	30'77	..
Public Lighting	554	6	10	..	..	0'90	..
Rental of Meters	98	19	2	..	..	0'15	..
Rents	19,741	7	9	..	27	3'63	31'82
Profit	£7,538	5	8	..	10	5'11	18'15

The form of Cost Sheet for Water Companies will be similar, except that the units of calculation will be per 1,000 gallons of water supplied and per £1 of rateable value of property in district.

	£ s d				Per Ton of Coal Carbonised				Per 1,000 Cubic Feet Sold			
	£	s	d	£ s d	£	s	d	£ s d	Pence	Pence	£ s d	Pence
Coal	8,791 0 11	..	..	..	18 1'90	..	..	..	24'17
Less Residuals—Coke	4,693 0 4	..	..	..	6 4'89	7'47	..	..	..
Breeze	118 6 0	..	..	..	1'96	0'19	..	..	..
Tar	1,002 10 3	..	..	..	1 4'64	1'64	..	..	..
Liquor	692 3 0	..	..	..	11'49	1'11	..	..	..
Total Residuals	6,445 19 7	..	..	..	8 10'98	..	..	..	10'39
Net for Coal	2,345 1 4	..	..	..	3 3'92	..	..	..	3'76
Purifying	443 7 11	..	..	..	7'36	0'71	..	..	..
Salaries of Engineers	390 0 0	..	..	..	5'81	0'36	..	..	..
Wages and Gratuities at Works	1,436 0 11	..	..	..	1 11'83	2'31	..	..	..
Repair of Works and Plant	3,816 7 6	..	..	..	5 3'34	6'15	..	..	..
..	341 0 0	..	..	..	5'66	0'55	..	..	..
..	115 7 3	..	..	..	1'91	0'19	..	..	..
..	687 10 6	..	..	..	11'41	1'11	..	..	..
..	558 17 10	..	..	..	9'28	0'90	..	..	..
..	738 16 3	..	..	..	1 0'26	1'19	..	..	..
..	420 0 0	..	..	..	6'97	0'68	..	..	..
..	14' 5 0	..	..	..	2'46	0'24	..	..	..
..	400 0 0	..	..	..	6'64	0'65	..	..	..
..	119 11 8	..	..	..	1'99	0'19	..	..	..
..	170 14 7	..	..	..	2'83	0'28	..	..	..
..	31 10 0	..	..	..	0'52	0'05	..	..	..
..	60 8 11	..	..	..	1'00	0'10	..	..	..
..	20 2 5	..	..	..	0'33	0'03	..	..	..
Total Working Expenses	9,858 0 9	..	..	..	13 7'60	..	..	..	15'89
Coal and Working Expenses, less Residuals	12,203 2 1	..	..	..	16 10'52	..	..	..	19'67
Sale of Gas. Private Lighting	17,245 8 6	..	..	..	..	..	..	..	..
Public Lighting	1,848 13 3	..	..	..	..	..	..	..	..
Rental of Meters	19,094 1 9	..	..	..	26 4'89	30'77	..	..	..
Rents	554 6 10	..	..	..	9'20	0'90	..	..	..
..	98 19 2	..	..	..	1'54	0'15	..	..	..
Profit	19,741 7 9	..	..	..	27 3'63	..	..	..	31'82
..	£7,536 5 8	..	..	..	30 5'11	..	..	..	12'15

The form of Cost Sheet for Water Companies will be similar, except that the units of calculation will be per 1,000 gallons of water supplied and per £1 of rateable value of property in district.

FOR CONTRACTORS.—Either of

Dr. SUMMARY OF COST LEDGER FOR THE

Contract No.	Fo.	Total to Debit from last A/c.	Wages		Materials	Plant	Stores	Petty Cash	Establish- ment Expenses	Total to Credit carried forward
			100's of days	Amount						
		£		£	£	£	£	£	£	£
462	166	15,000	150	4,000	500	..	1,000	..	300	..
469	169	20,000	200	5,000	2,000	350	750	..	400	..
470	170	..	225	8,500	10,000	3,000	2,750	25	450	..
471	171	..	300	6,850	2,000	750	500	50	600	..
472	172	..	250	7,500	9,000	900	3,000	25	500	..
		£35,000	..	£31,850	£23,500	£5,000	£8,000	£100	£2,250	..

Sundries £25,000
Stores .. 5,000
Plant .. 5,000
£35,000

FORM OF CASH BOOK.—A good form of Cash Book not only saves time and trouble every day of the year, but also—to an even greater extent—when the Ledgers come to be balanced.

It is impossible to go fully into this matter here, but it is suggested that, in all businesses of any magnitude, the Auditor should consider the advisability of recommending the introduction of various columns into the Cash Book that would facilitate the balancing of the various Ledgers employed. In an extreme case, the use of a Ledger might be almost obviated by the use of a numerous-columned Cash Book; and in many cases a little ingenuity will suffice to materially reduce the labour of posting during the year, and, to a corresponding extent, facilitate the balancing of the Ledgers at the year's end.

The author has seen a Cash Book ruled with special columns for Bills, thereby doing away with the Ledger Accounts, but in this specific instance the result was not particularly happy. The abolition of the Ledger Accounts (where expedient) is best managed by elaborating the Bill Book into a Bill Ledger.

In large concerns a great saving of time may be effected by assigning a separate Cash Book to each Ledger clerk. These separate Cash Books will, of course, all work into the General Cash Book. (See further, under "Self-balancing Ledgers," *postea*.)

DISCOUNT AND INTEREST.—A considerable amount of time may be saved by a proper system in recording cash discounts. Every trading or manufacturing concern should have discount columns in its Cash Book; by which means the necessary number of postings may be considerably reduced. The common practice of posting the total of the debit discount column to the debit of the Ledger, and *vice versa*, is, however, essentially unscientific. An entry should be made at the foot of the debit column for the total amount of discounts received, and posted thence to the credit of the Discount Account; while on the credit side of the Cash Book an entry is made in the discount column of the total amount of discounts allowed,

which is posted to the debit of the Discount Account. By this means the total of the debtor and creditor discount columns will be made to agree—just the same as the two bank columns, or any other two corresponding columns, agree—while the advantage of posting totals to the Ledger Account, instead of differences, is not lost. Moreover, the rule that the debit cash entries are posted to the credit of the Ledger, and *vice versa*, is uniformly maintained, which will always be an advantage theoretically, and—where one is dealing with second-rate book-keepers—practically as well.

In every case, whatever method be adopted, the total of discounts received must be credited to Profit and Loss, and the total of discounts allowed debited. A further consideration arises, however—namely, that, while discounts are theoretically supposed to represent an allowance granted for a payment made before it is due, it is an almost universal custom to deduct discount from all outstanding accounts at balancing time, and to amend the Profit and Loss Account accordingly. The position is not very logical; but where, upon the whole, discounts show a loss, there is much to commend it. The reader will find some valuable food for consideration in a contributed article in *The Accountant* of the 27th September 1890, which he will do well to study, even though he may not see his way to put the writer's theories into practice.

CASH DISCOUNTS (so-called) received on account of Capital Expenditure by a Parliamentary Company are clearly a reduction of such Capital Expenditure; the only exception being where dividends are authorised to be paid out of Capital, in which case such dividends (which correspond to a cash discount) have to be capitalised.

INTEREST, received and allowed, requires to be separated in the Profit and Loss, just the same as discount; and, where it is desired to reveal the whole effect of the working of a concern, it is advisable to separate discount from interest.

The question of outstanding Discount and Interest is dealt with more fully in the following chapters.

BANK CHARGES.—Before taking leave of the Cash Book, it is well to note that the Auditor should always roughly check the bank charges debited to his client, and see that the rate actually charged is in accordance with arrangements made. Unless thoroughly checked, bank charges have frequently a curious habit of increasing from year to year.

PETTY CASH.—The author is acquainted with two good systems of Petty Cash, and with numerous bad ones. It is not proposed to deal with the latter, but a good system is sufficiently uncommon to merit a record in these columns.

The system of debiting Petty Cash payments *en bloc* to Profit and Loss is bad; and it is therefore assumed that, under each of the following methods, the various payments are periodically analysed. Petty Cash should be balanced at least once a month, and frequently it will be found advantageous to balance at even shorter intervals. The analysis may be made either by means of analysis columns in the book itself, or by a summary written in the book and prepared on loose dissecting sheets, as may be found most convenient.

Under one system the Petty Cashier is started with an amount, say £20, which is supposed to be more than sufficient for the payments for the month (or whatever other period be adopted). At the end of the month he hands the cashier a summary of his payments, and receives a cheque for that amount. On the counterfoil of the cheque, the summary (or a reference to it) is written, and the cheque is written up in detail in the Cash Book at once, and thence posted direct to the debit of the various accounts. Under this system no Ledger Account is required for Petty Cash, but an account should in every case be opened for the initial balance, as, if it be left as a floating balance on Office Expenses, or any other Nominal Account, it is apt to get lost sight of. The cashier should thoroughly examine the Petty Cash Book each time he draws a cheque; and when the cheque has been cashed, the initial balance should be shown him intact. The Auditor

also will, of course, require to see this balance, or to have it properly accounted for.

The other system is more suitable where the expenditure is too large for it to be deemed desirable to trust the petty cashier with an amount sufficient to cover a month's expenses.

In this case, there will be a small initial balance, and when it becomes nearly exhausted a cheque will be given for the exact amount spent up to date. This system is thus similar to the former, but with shorter rests; but to avoid numerous entries in the Cash Book the cheques drawn (including that for the initial balance) are posted to the debit of a Petty Cash Account in the Ledger. The result of the monthly summary is credited to Petty Cash Account, and debited to the various Nominal Accounts, either by being posted direct from the Summary, or by means of a Journal entry. The balance of the Petty Cash Account at the end of each month will thus always represent the amount of the initial balance.

It will be noticed that debiting Nominal Accounts has always been spoken of. In the comparatively rare cases where it is desirable to make Bought Ledger, and other, payments (which involve the debit of a Personal Account) by Cash, every consideration of convenience will tend to the use of a separate Cash Book for this purpose, which will, of course, be kept upon similar lines to those indicated.

A good system of Petty Cash is of the greatest value, both to the Auditor and to his clients, and it is therefore always advisable that the Auditor should use his influence in this direction.

RENTS (RECEIVED AND PAID).—Where a considerable portion of the income is derived from the receipt of Rents, it is probable that some reasonable system of Accounts will be found in connection with them; but where the matter is, so to speak, a side issue, the probabilities are that there will be found to be no system whatever. Cottages let to workmen are, perhaps, the most ordinary instance of a revenue

being incidentally derived from Rents Received; and, as a rule, the accounts in connection with them will be found extremely primitive. The usual method is to deduct the amount of rent from each man's pay, and credit the total deductions to a Rent Received Account. This method might answer if the proper deductions were invariably made; but under such a system—if a man were allowed to get into arrear, or if no wages were due to him—the matter is very liable to be lost sight of; and, in any case, no proper record will be kept of any allowances made to tenants for taxes, repairs, &c. In every case, therefore, a proper rent-roll should be kept. In general, this will be found an actual saving of time in the end; and, in any case, it will probably save its cost in the increasing resultant revenue.

A specimen of what is regarded as a good form of rent-roll, where rents are paid weekly, is appended. The same form would apply equally well to monthly rents, and those paid at less frequent intervals will present far less difficulty. It may be noted that the columns of the totals of weekly rents should in all cases be checked with the debit side of the Cash Book in total, although for practical purposes it is hardly necessary that the details should be compared. If the matter is a small one, however, of course no harm can result, and much benefit will accrue from an exhaustive examination.

The proportion of rent accruing, but not due, should be included in the Balance Sheet as an asset; as also should all arrears, unless, indeed, there is reason to believe that they will not be recovered. All accruing and outstanding liabilities for ground rent, rates, taxes, &c., must also be included, and the Auditor must not be put off with any suggestion that "they about balance one another." What he has to deal with are the facts.

In the case of cottage property, occupied by workmen, it is desirable to show the whole matter in a nutshell in the Profit and Loss Account; therefore show Rents, less Outgoings, on the credit side, and carry out only the net Revenue derived.

Where only a portion of certain premises is occupied, and the remainder sub-let, a similar course should be pursued. That is to say, the total rent paid should be shown on the debit side, the rent receivable deducted, and the net rent paid carried out. It is considered in some quarters that a statement of the net amount is sufficient; but the effect of the sub-let premises becoming vacant should be considered, for if this be neglected, the amount stated in the accounts will be liable to sudden and unexplained fluctuations. If accounts are intended to show the whole facts of the case, it will be seen at once how defective are statements containing the net amount only.

RENTS PAYABLE.—Where the business is carried on in freehold premises owned by the proprietors, there is no reason why the Rent Account should not be charged with a fair amount for the use of the premises. This practically amounts to the proprietors giving themselves a lease of the property, which naturally leads to a consideration of the question of leaseholds.

WHERE A VALUABLE LEASE is held, for which a premium has been paid, the annual amount written off for depreciation may appropriately be charged to Rent Account, it being, in fact, merely a portion of the rent paid in advance; but it would be well for the accounts to state that this has been done. By

"annual payment" it will, of course, be understood that depreciation, pure and simple, is referred to, irrespective of interest; the Profit and Loss Account must be credited to "Interest on Investments" in the usual way. A useful Depreciation Table will be found in Appendix "D."

Where property is held upon a repairing lease, and the term is short, it will probably be necessary to make provision for whatever liability may eventually accrue for dilapidations. This is, of course, a matter in which almost everything depends upon the facts of the particular case. It is, therefore, impossible to deal with the question so fully as its importance would seem to require; but the matter is considered at some length under the heading "Depreciation," in a subsequent chapter.

"SELF-BALANCING" LEDGERS.—All Accountants—and, for that matter, most Bookkeepers—will be familiar with the method usually adopted for verifying the accuracy of each Ledger in a system of accounts. It would probably be the exception to find a set of books in which some device for the separate balancing of each Ledger was not in use; on the other hand, the instances in which some properly *organised* system of applying this check has been adopted are probably more exceptional.

The usual method is to take the total of the list of Ledger balances at the previous time of balancing, allow for the total amounts that should have been posted to the debit and credit of the Ledger respectively, and the resultant figure should agree with the total of the present list of balances. This method is often of the greatest possible assistance when dealing with books that have been more or less incompletely kept; but it can hardly be called scientific, and is, at best, but a convenient makeshift, nor can Ledgers so kept be properly styled "self-balancing."

Every Ledger should be so arranged as to possess within itself all the materials of a Trial Balance. That is to say, each Departmental Ledger should contain a General Ledger Adjustment Account, while the General Ledger should contain

an Adjustment Account for each of the Departmental Ledgers. The detailed consideration of this matter is, however, a question of Bookkeeping rather than Auditing; it will accordingly be found to be fully dealt with in the author's *Bookkeeping for Accountant Students*. The Adjustment Account is a most valuable device, as by this means each Ledger can, at any time, be balanced with the minimum of trouble, and absolutely irrespective of the other Ledgers. Moreover, in the event of any Ledger not agreeing, the side (whether debit or credit) upon which the difference occurs can be readily perceived.

Hence it follows that a *rough* Balance Sheet and Profit and Loss Account can always be prepared in a very short space of time, without involving the labour of balancing every Ledger. Again, the clerk keeping the General Ledger (naturally the clerk most to be trusted, if not actually one of the principals, or, perhaps, even the Auditors themselves) has a very good check on every other Ledger clerk. It must, however, never be lost sight of that the only reliable verification of the various balances of the Adjustment Accounts in the General Ledger lies in the thorough verification of the various Departmental Ledger balances. If this fact be lost sight of, there is a possibility of fraud; but, if the system be intelligently applied, it is a distinct preventive of any kind of irregularity.

The Auditor who once adopts this system will find it not only lessen his own work and that of the bookkeeper, but also add to the completeness of whatever system may have previously been in use; and, further, materially increase the pleasure attendant upon the investigation. Where the Auditor himself keeps the Private Ledger (a not uncommon practice where private persons and firms are concerned) the advantage of making each Ledger "self-balancing" must be sufficiently obvious to need no further demonstration.

WHERE A PROPER STOCK ACCOUNT IS KEPT, or there is a reliable means of estimating the amount of Stock on hand (*cf.* Stock Accounts), the existence of "self-balancing" Ledgers makes it possible for a reliable Balance Sheet and Profit and Loss Account to be prepared, at any time, in a few hours, or

even minutes; and the advantage of this—where no Cost Accounts can be kept—is hardly to be over-estimated.

TABULAR LEDGERS.—Another form of self-balancing Ledger—to which indeed the term “self-balancing” may, perhaps, be more appropriately applied than to the kind described in the preceding paragraph—is the Tabular Ledger. This Ledger is suitable to those concerns in which accounts are rendered only at certain definite intervals, and where the number of customers is extremely numerous, while the number of transactions with each customer is but small. These limitations naturally reduce the general utility of Tabular Ledgers, but they are common with gas companies, water companies, electric light companies, and also for the purpose of recording the collection of rates made by various local authorities. In each of these cases the account rendered to the customer virtually consists of a single item, but the same form of Ledger is sometimes found convenient in cases where a large number of items have to be recorded; in these latter cases, however, a subsidiary Ledger has to be kept for the purpose of collecting the items which constitute the account to be collected. Under ordinary circumstances the extra labour involved would go far to prevent the employment of tabulated Ledgers in such cases as this, but it sometimes occurs—*e.g.*, in the case of a colliery—that the daily deliveries are only invoiced as regards weight and quality, without being priced out, and that the subsidiary Ledger is also kept in quantities only; the pricing out being only done when the monthly statement of account is sent in, and this being so, a tabulated form of Ledger might conveniently be adopted in such a case, although probably the number of accounts would not be sufficient to render such a course imperative.

Yet another form of Tabular Ledger is that in use at hotels. The especial object of this form is to make the Ledger do duty not only as a personal Ledger showing the state of account between the hotel and the various visitors, but also as a nominal Ledger showing the analysed receipts from day to day. This form of Ledger is especially applicable to hotels, on account of the large number of nominal accounts employed

to analyse the income derived from various sources; it is also most convenient on account of the fact that it presents the readiest means of keeping each account written up to date, with a minimum of labour.

STOCK ACCOUNTS.—In many businesses it is quite practicable to keep a reliable record of all goods or stores in stock, and—wherever this is possible—it is clearly desirable that the Auditor should place before his clients the indisputable advantages of such a course.

Full details as to the best method to be adopted in all cases would naturally involve a consideration of the particular stocks employed in various trades and manufactures, and would be out of place in this volume, but the following general recommendations (quoted from *The Accountants' Manual*, Vol. II.) will doubtless prove sufficient for the purpose:—

“(1) Debit and Credit Accounts should be opened, as far as possible, for each description of Stores used. On one side of the accounts the receipts would be entered, showing the date, weight, quantity, or number, and other particulars; and, on the other side, the stores given out from time to time would be entered, with such particulars as were necessary or suitable, the difference representing what ought to be in hand, or thereabouts—as, in accounts of this kind, the balance shown upon the accounts can hardly be depended upon exactly.

“(2) It is the opinion of practical mill-owners and managers that in many cases a really efficient and exact check on Stores is not practicable. It could, no doubt, be devised; but the detailed work in connection with it, and consequent labour and expense, put it out of the range of every-day business, whatever theorists may say. But many useful rules may be laid down preventive of fraud and waste, amongst others the following, taken from actual experience:—

“(a) Where stores are distributed for use upon a specific job, the job should be stated, with the weight, quantity, &c. At Newcastle-upon-Tyne lately, a vast system of fraud was discovered, which had gone on for years; in part through the

neglect to adopt the recommendation of the Auditors (Chartered Accountants) that proper Store Accounts should be kept.

“(b) If material of the same kind is distributed to various men for the same purpose, a comparison should be made between the results produced by each. If discrepancies are found enquiries should be made, and doubtless in some cases a good explanation could be given: *e.g.*, old machinery or appliances, &c.

“(c) The store room should be so situated that people going in and coming out would pass under the eye of the principal, manager, or some other responsible person.

“(d) The principal, or manager, should make a point of examining at times the Stock Ledgers and taking a general supervision of the department. Frequent and unnotified visits should be made, and the storekeeper, *if possible* (it is not always possible), changed [occasionally].

“(e) Some kinds of stores should never be given out unless the used-up stores are returned. For example, a workman making requisitions for files, brushes, and like things, should only be supplied on his giving up the old articles. This is a very good check, when the nature of the stores will allow of its application.”

It will be perceived that the above considerations refer primarily to the stores purchased by factories for their own use; an ordinary amount of intelligence will, however, suffice to render the recommendations there made applicable to a trading concern—that is to say, a concern where the goods purchased are issued (sold) to outside persons. A very simple system will be found fully described in Part III. of the author's *Bookkeeping for Accountant Students*.

In designing Stock Accounts for trading concerns (and sometimes, also, with manufactories) it is possible to arrange for the keeping of the accounts in sterling as well as in weight or quantity; and, where this can be done, it is clearly desirable—as it is then possible—to make the Stock Accounts part of the regular system of double entry bookkeeping

employed. It is, however, always better to retain the record of weights or quantities, as otherwise a discrepancy in quantity might easily be concealed by an error in the values attached to the various stores.

TRADERS' ACCOUNTS.—With some businesses (especially traders dealing in small articles broken from bulk) a regular system of Stock Accounts is not practicable. In this case a different method of check must be employed. In every trade there is a well-known gross profit that ought always to be earned, and can rarely be exceeded. If, therefore, the Stock Account is started with the actual stock on hand at the commencement of a period, debit the account from time to time (usually monthly) with the total purchases, and also with the aforementioned estimated gross profits on the sales, and credit the account with the sales; the balance shown will then represent the stock on hand—estimated on the assumption that the nominal gross profit has been exactly earned. At the periodical stock-taking this estimate can, of course, be easily verified, or corrected. Where an undertaking trades in various kinds of goods, it is always desirable to dissect the sales and purchases, so that the position of the various departments may be readily perceived.

This system is in very general use, and serves two most useful ends. (1) It calls attention to any discrepancy between the actual and nominal gross profits, by means of a similar discrepancy between the ascertained and estimated stock in hand. (2) It affords most useful information as to the probable amount of stock in each department from month to month, and so serves as a guide to, and a check upon, the various departmental managers, as well as affording material for an interim Balance Sheet, if one be required.

It is, of course, impossible to give any definite information concerning the gross profits usually made in various retail trades. Naturally, everything depends upon the situation of the shop, and the class of business done. The following table of estimated gross profits realised on so-called "Stores prices" by a leading London house will not, however, be without interest :—

Grocery	...	...	10 per cent.
Wines and Spirits	...	...	15 "
Cutlery	...	...	15 "
Drapery	...	...	10 "
Stationery	...	...	15 "
Jewellery	...	...	25 "
Drugs	...	...	25 "
Provisions	...	...	8 "
Beer	...	...	10 "
Tobacco	...	...	7½ "
Tailoring	...	...	12½ "
Mantles and Dresses	...	...	17½ "
Meat	...	...	10 "
Fancy Goods	...	...	17½ "

It is not, of course, suggested that these rates will apply to all houses selling at "Co-operative prices" (for the very term itself is sufficiently elastic), but they will serve as a useful guide of the gross profit likely to be earned by a house doing a good class ready-money trade.

It is, perhaps, well to note that, in accordance with the invariable custom of traders, the above percentages are based upon the *selling* price of the goods, and not on the cost price.

It may be added that a comparison of the ratio between the stock in trade and the sales during corresponding periods is often useful as a rough test of the accuracy of the stock-taking.

In conclusion, it may be stated that the Auditor who has been requested to design Stock Accounts for any special business will do well to avail himself of whatever practical experience may be possessed by his clients, or their managers. Nevertheless, he should take the earliest possible opportunity of verifying the experience thus utilised by his own; and, where he should be so fortunate as to possess some slight practical knowledge of the particular business in question—a knowledge he is very likely to have had the opportunity of acquiring in connection with the winding-up of insolvent estates—he will doubtless find it of the greatest assistance.

STOCK AND SHARE ACCOUNTS OF COMPANIES.

—With regard to these accounts, much that might have been said has been anticipated under the heading of “SELF-BALANCING LEDGERS” (*q.v.*). Each class of shares or stock should have an account opened for it in the General Ledger, and such account will, in fact, become the Adjustment Account for that particular Share Ledger. By this means all transfers are kept out of the General Ledger, and—after the issue has once been completed—no further entries are necessary. Should the issue be a large one, however, it is often preferable to open separate General Ledger Accounts for “applications,” “allotments,” and “calls,” respectively.

This system may be greatly assisted by the addition of an extra column to the debit side of the General Cash Book, the items entered in such column being posted to the Share and Stock Ledger, and the totals periodically extended into the Bank column, and these posted to the General Ledger in the usual way. If this method be adopted, the duplication of entries is reduced to a minimum, and the Auditor's work becomes not only proportionately lighter, but also much more certain.

With large companies, whose shareholders are numerous, it will be usual to devote a special book to Capital receipts, and carry totals only to the General Cash Book. This system lends itself readily to the method advocated.

For full information upon this subject the reader is referred to the author's “Bookkeeping for Company Secretaries.”

SUSPENSE ACCOUNTS.—Most of the points comprised under this heading will be found most fully dealt with at a later stage, under the heads of “Outstanding Assets and Liabilities” and “Contingent Liabilities”; but the following, which refer rather to questions of account than to general matters of principle, may be more appropriately considered here.

Any outstanding amounts due, or supposed to be due, either to or by an undertaking, should never be allowed to stand

as balances upon a Nominal Account. The great convenience of bringing the balance down on the Nominal Account, as opposed to opening a Suspense Account which will naturally have to be closed the following morning, makes this method of bookkeeping—if, indeed, it can be called a method—a great favourite with a certain class of bookkeeper; but the objections that can be raised against such a procedure are quite sufficient to outweigh any advantages which it may be supposed to possess. From a bookkeeper's point of view, doubtless, the balance on the Nominal Account may be deemed to answer all purposes sufficiently well, but the Auditor must take a higher view of matters. In the first place, the balance is very apt to be lost sight of, and consequently no adjustment made, at the close of the next period—particularly where a standing balance of petty cash in hand is left open upon, say, the Office Expenses Account. Secondly, the method is open to abuse on the part of a fraudulent bookkeeper, and—in the absence of the suggestive headings of Suspense Accounts—the matter might possibly escape the vigilance of the Auditor. And, again, it is a distinct advantage to arrange the Trial Balance so that it may contain, in itself, all the information necessary for closing the books, and preparing the Balance Sheet and Trading and Profit and Loss Accounts, and this can only be conveniently effected by making the necessary adjusting entries, by means of Suspense Accounts, before the Trial Balance is extracted.

The author is confirmed in the above opinion by an admirable series of "communicated" articles which appeared in *The Accountant* of the 19th April and 3rd and 10th May 1890, which may, with advantage, be perused by all who may require any further information upon the matter.

THE TREATMENT OF BAD AND DOUBTFUL DEBTS.—An intelligent system of dealing with the difficult question of Bad and Doubtful Debts is of such assistance to all commercial houses that the Auditor should lose no opportunity of suggesting that the matter be put upon a scientific basis.

A very good method is the following :—

As soon as a debt becomes at all doubtful, or sufficiently overdue to merit special attention, it is transferred to a Doubtful Debts Ledger, which is ruled as follows: On the left-hand page are spaces for two or three ordinary Ledger Accounts, while the right-hand page is left blank for such memoranda as "When applied for," "When sued," "When failed," and full particulars as to progress of subsequent realisation of the estate. When an account becomes hopelessly bad (either by reason of the Statute of Limitations intervening, or an execution remaining unsatisfied, or a final dividend having been distributed, or a composition accepted), *and not until then*, the Account is written off to Bad Debts Account; but on no account should an amount be written off until it is known to be irretrievably bad; as an amount, once written off, is almost certain never to be recovered. It will be noted that not the least of the advantages afforded by this system is the peculiar prominence it gives to all overdue Accounts, thus offering special facilities for their receiving the particular attention they so urgently require.

Where it is the custom to pass all overdue debts over to the solicitor for collection, their simultaneous transfer to the Doubtful Debts Ledger provides a convenient record of all matters in the solicitor's hands.

The necessary provision for loss upon Bad and Doubtful Debts may be made by means of the Reserve for Bad Debts Account, which may be credited with the estimated amount of such loss, while the Bad Debts (nominal) Account is debited in the usual way. The memoranda recorded on the blank pages of the Doubtful Debts Ledger will readily afford all available information upon which a proper valuation of the amount necessary to be written off may be prepared, and the systematic focussing of such information upon the method here described will generally admit of a much more reliable estimate being prepared than would otherwise have been practicable.

Some persons prefer to base their valuation upon a certain percentage of the Sales, and so equalise the loss by charging

each year only with an average amount. The argument in this case is that the loss was not really made in the year when it was discovered, but in the year when the sale was effected. The contention is ingenious, but not particularly sound. In any case, the Auditor should satisfy himself that the Balance Sheet he is required to certify does not overstate the amount of the Book Debts; on the other hand, there can be no objection to a moderate reserve being built up to meet losses that may be incurred in the future.

THE USE OF THE JOURNAL.—The extent to which the much-abused Journal may be advantageously employed in modern commercial Bookkeeping is a question upon the discussion of which so much acrimony has already been unprofitably expended that it is with considerable diffidence that the subject is approached at all.

After all has been said, however, the fact remains that many classes of business may, without any considerable loss of labour, employ the Journal summarising for all kinds of General Ledger transactions, except cash. In such cases—and, be it noted, such cases are referred to only—it appears to be a considerable advantage to pass the Cash *totals* through the Journal, and so obtain from the Journal the sum total of all transactions, which may be then checked against the *totals* of the Trial Balance, which will be taken out in four columns (upon the French method) for this purpose.

Where this is done, an error in the Trial Balance may be localised, as to debit or credit, and a considerable amount of time will thus be saved in effecting a final agreement.

It is not, perhaps, very often that this method of balancing by totals will be found to be practicable, but it is, at the same time, much more frequently possible than some would appear to think; and the safeguard it affords against fraudulent transfers in the Ledger, between Nominal and Personal Accounts, is an advantage not to be lost sight of where other circumstances are equal.

Where this check of the totals of the transactions is not practicable by means of a regular Journal, it may often be effected by the Auditor constructing an equivalent for the Journal from the totals of various other Books, and—where this is practicable—the Auditor should not let the opportunity escape him.

WAGES AND SALARIES.—The best method of paying wages has already been detailed in Chapter I., and therefore nothing further need be said upon that subject here.

SALARIES should, in large concerns, be dealt with in a manner as near thereto as practicable. The distinction made by writers between wages and salaries is by no means invariably clear, and therefore some definition seems desirable. By Wages is meant the cost of labour, and also the cost of the immediate supervision of such labour (foremen, &c.), which would probably be paid for at the same time and in the same manner—in a word, cost of artizans' or labourers' work. By Salaries is meant the weekly or other payments to managers, salesmen, clerks, and other more educated workers. Thus, wages will be always an expense of production; but salaries may be an expense of production, distribution, or administration, although generally one of the two latter. The above definitions are by no means universally accepted, but for present purposes the classification according to method of payment and of audit appears to be the most convenient.

A **SALARIES LEDGER** may be regarded as essential in all but the smallest concerns. An account should be opened for each person in receipt of salary, and the rate and time of payment stated at the head of the account. Each payment will be entered on the account as made, and duly signed for, by the recipient. This Salaries Ledger has, it will be seen, no credit side, and is purely a statistical book. Many retailers, and others, make a special agreement with their hands so that they may be dismissed without notice; where this is the case the form of agreement may appropriately be printed at the head of each account, and it will be convenient to have a sixpenny agreement stamp embossed upon each page.

The SALARIES BOOK contains a list of each set of payments, the total corresponding to the amount of the cheque drawn, and the items bearing the folios of the various Ledger Accounts.

The Auditor need not do more than check the additions of the Salaries Book and the postings of one or two weeks; but he should take a look through the whole Ledger, page by page, and he should never volunteer to any of the staff the information that he does not check every figure.

AGENTS' ACCOUNTS.—With books which are not kept by very skilled bookkeepers, the auditor frequently has a considerable amount of additional, and wholly unnecessary, trouble in connection with the accounts between his client and their agents, or between his client, the agent, and his principals. It is therefore very desirable that Agency Accounts should be kept upon some definite and practicable system. The conditions of agency are so various that it is impossible to deal in detail here with every conceivable set of circumstances arising in connection with this subject, but it may be pointed out, in general terms, that where the remuneration of the agent is dependent upon the amount of sales or purchases effected by him every consideration of convenience is in favour of a special Sold or Bought Book being employed for his transactions; or, at all events, a special column being devoted to these transactions in the general Sold or Bought Book, as the case may be. When, on the other hand, the remuneration of the agent is by way of profits, or a percentage on the profits earned, whether gross or net, the accounts should be so schemed that an "Agency Account" is opened in the General or Private Ledger, which virtually becomes the Trading, or Profit and Loss, Account in respect of the transactions with which the agent is concerned.

From many points of view there is much in common between Agency Accounts and Consignment Accounts, and therefore the considerations obtaining under the latter heading will frequently be found of use in connection with the accounts between agents and principals, and may be usefully consulted

before formulating any definite scheme upon which these latter accounts should be kept.

CONSIGNMENT ACCOUNTS.—It has already been pointed out under the previous heading that the most convenient method of dealing with many Agency Accounts is to so arrange the books that what is virtually a special Trading, or a special Profit and Loss, Account should be kept in respect of these particular items. These remarks apply *a fortiori* to Consignment Accounts. The statement will be found in many text-books on bookkeeping (chiefly, however, of the unpractical order) that when a consignee receives goods for a consignor it is unnecessary that any entry should be made in his books in respect thereof. This, it will be obvious, is a complete departure from the fundamental rule of bookkeeping, which requires that it should be “a record of transactions,” and this proposition seems so self-evident that no time will be wasted in more fully discussing it. Apart, however, from this academical objection, it may be pointed out that every consideration of convenience requires that in the books of the consignee there should be two accounts for the purpose of recording his transactions with the consignor; the one virtually a Trading Account, showing the actual result of the trading in the goods consigned, and the other a Personal Account, showing the position between the consignee and the consignor.

The same remarks apply to the books of the consignor himself, except that—as he is dependent entirely upon the consignee for the record of transactions after the goods have once left his office—it becomes possible in some cases to adequately record these transactions in one account. In the vast majority of cases, however, it will be found that two accounts are not only more convenient, but in the long run involve less trouble and time in the keeping.

A fuller and more detailed exposition of the best method of dealing with these accounts will be found in the author's *Bookkeeping for Accountant Students*, to which the reader is referred.

THE ACCOUNTS OF BRANCH ESTABLISHMENTS.—This is a point upon which the Auditor will frequently experience considerable difficulty, by reason of the defective system of record employed, and it is therefore of especial importance in connection with the subject of auditing that a really practical system of bookkeeping should be dealt with in this connection.

It may be stated at the outset that the accounts of branch establishments may be ranged under two wholly different categories. In the first case, the accounts of the branch are kept at the branch itself, and are practically independent of those kept at the head office; in the second case, a minimum possible amount of accountancy is employed at the branch, returns being made to the head office, and the transactions of the branch incorporated in the Head Office Books. The latter class of accounts, of course, present no serious difficulty, and, indeed, for all practical purposes the bookkeeping is the same as though the branch establishment did not exist, except that for statistical purposes it may be thought desirable that some of the Nominal Accounts should be divided up so as to show the transactions of the branch separately for purposes of comparison.

It is, however, with regard to the former class that most difficulties are likely to arise. In this connection it may be pointed out that any difficulty or complication which can be conceived can be at once got over if the system of accounts at the branch office be regarded in precisely the same light as though the Ledgers recording these transactions were in point of fact kept at the head office in Self-Balancing Ledgers, in respect of which Adjustment Accounts were to be found in the Head Office Ledgers themselves. These Adjustment Accounts in the Head Office Ledgers, which, of course, will be written up from returns made by the branches, will provide the means of controlling the record of transactions in the Branch Ledgers, and at the same time combine the whole system of accounts into one entity. On the other hand, there should, of course, be Adjustment Accounts in the Branch Office Books, so that these themselves may be made self-balancing.

When balancing time comes it is necessary that a Trial Balance should be taken of the Branch Books, and remitted to the head office, and this will be found to explain and verify the Adjustment Account in the Head Office Books dealing with the branch transactions. The Trial Balance at the head office can then be amplified so as to give effect to these records.

Before leaving the question of Branch Accounts it may be pointed out that the balance of expediency lies in favour of the branch's bank being a branch of the same bank as that employed at the head office, so that facilities may be afforded for a prompt return being made to the head office of the payments into and out of the branch's banking account. On the other hand, in many cases it will be found preferable not to employ any banking account of the branch at all, but to receive and pay all accounts through the head office alone; and, where the nature of the business renders this possible, every consideration of expediency will be in favour of its being carried out.

Another point which is well worth bearing in mind, where it can be practically applied, is that with certain classes of business—that is to say, those which deal with the sale of goods in bulk without the bulk being broken, it is of inestimable advantage for the purchases to be all made at the head office, and the goods supplied to the branch offices being supplied to them by the head office at selling price. The Stock Account at the branch office then becomes much simplified, and the balance of such Stock Accounts should represent the stock actually available on hand, without any adjustments being necessary in respect of estimated or actual gross profit. It is not necessary that this system should at all confuse the question of the profits actually earned by the branch, because there is not the least difficulty in the goods supplied to the branch being credited to a Special Account in the Head Office Books, instead of being credited to the General Sales Account.

The mere fact that a business has numerous branches, instead of merely one, in no way alters the fundamental principles on which the accounts of these branches should be kept; but it need hardly be added that it enormously increases the

arguments in favour of these Branch Accounts being organised and rigidly kept upon a thoroughly sound basis of internal check, and one which renders itself readily available to the scrutiny and supervision of the Auditor.

CAPITAL AND REVENUE.—The distinction between Capital Expenditure and Revenue Expenditure is one of primary importance, as bearing upon the fundamental question of what profits have actually been made by an undertaking during any given period. But it is thought that much unnecessary complication has been introduced in discussing this subject, and that, when these wholly irrelevant matters are brushed aside, the fundamental question will be found to be simplicity itself.

Shortly stated, the question can in any event be answered by finding the answer to the following question: "Has the particular expenditure incurred in any individual case been incurred for the sake of improving the earning capacity of the undertaking?" If the answer to this question is in the affirmative then the expenditure in question is capital expenditure, unless it has only had the effect of putting the earning capacity of the undertaking upon the same footing as that which had previously obtained, and which has since declined by the ordinary process of wear and tear, or the effluxion of time, in respect of which no provision has been charged against revenue. The precise meaning of this latter qualification is that the mere *renewal* of fixed assets cannot be called capital expenditure, but that any extensions or the acquiring of fresh assets is in the nature of capital expenditure.

In all cases, however, there should be charged against revenue not only the ordinary current working expenses, but also a sufficient sum, either to provide for the waste which necessarily occurs in the use of the fixed assets, or else the actual cost necessary to keep those assets in a state of perpetual efficiency.

PARTNERSHIP AGREEMENTS.—There is an increasing tendency upon the part of commercial men entering into partnership to consult Professional Accountants as to the

provisions which should be made in the partnership agreement with regard to the accounts to be taken in the partnership. This tendency is distinctly one to be encouraged, as having in the long run the effect of not only consulting the immediate interests of the partners with regard to the keeping of proper accounts, and the equitable apportionment of profits, but also as tending distinctly to lessen the probability of disputes in the future arising out of questions of account.

The subject is, therefore, one which may be very profitably undertaken by professional accountants, and that without in the least usurping the functions of solicitors. This being so, it has been thought desirable to append a few notes as to the points most ordinarily arising in partnership agreements, together with suggestions as to how they should be dealt with.

These are as follows :—

(1) The respective shares of partners in profits and losses should be clearly stated; and where it is provided that these shall be varied during the continuance of the partnership, it is especially important that anything which might tend to affect the amount of agreed profits as between the partners should be very clearly defined.

(2) It should be borne in mind that, in the absence of express provision to that effect, partners are not entitled to interest upon capital. If, therefore, they are to receive interest, the fact should be clearly stated.

(3) The law provides for interest at the rate of 5 per cent. upon *loans* by partners to the firm. If, therefore, any qualification of this provision is desired, it should be expressly provided for.

(4) Not only should the amount of capital to be introduced by each partner at the outset be expressly defined, but provision should be made as to the manner in which undrawn profits are to be dealt with. That is to say, whether they are to be treated as capital or as loans, the distinction being, of course, especially important where it is provided that capital does not bear interest but that loans do.

(5) The amount to be drawn by each partner from time to time on account of profits should be clearly stated, together with the penalty in the event of such limit being exceeded.

(6) If it is desired that interest should be debited to partners in respect of drawings, the fact should be clearly stated.

(7) The circumstances under which a partnership may be dissolved should be clearly provided. Too much attention cannot be given to this point.

(8) The exact position of each partner, in the event of a dissolution, is also a matter of the very greatest importance.

(9) In the event of a partner retiring, or dying, the deed should distinctly provide the amount payable to him (or to his representative, as the case may be), and also the time in which it must be paid, and the interest (if any) it is to bear in the meantime.

(10) In connection with the preceding it is frequently convenient that some special arrangement should be made to obviate the necessity of the books being balanced and stock taken at an irregular period.

(11) The exact scope of the firm's business should be clearly defined, with a view to avoiding disputes as to whether certain profits earned by the individual partners come under the partnership deed or not.

(12) The extent (if any) to which partners are entitled to engage in other operations should be defined.

(13) It should not only be provided that "proper accounts are to be kept," but that these should be kept upon some adequate system of double entry. They should be balanced at stated intervals, and audited by a professional accountant, and provision made that after the audited accounts have been signed by the partners they are binding upon each individual partner, except where some manifest error has been discovered within a reasonable time—say, three months.

(14) In addition to the usual arbitration clause, it is very expedient that there should be one to the effect that all disputes upon questions of account should be referred to the

arbitration of a Chartered Accountant (preferably, if the question of expense is to be considered, the regular auditor of the firm), and it should be further provided that, in the event of disputes upon questions of mixed law and accounts, such disputes should be referred to the arbitration of an accountant and a solicitor or barrister, the arbitrators having power to appoint an umpire before commencing their reference.

INSTRUCTIONS AS TO PREPARATION FOR AUDIT.—As a fitting conclusion to the present Chapter, a brief list of instructions—such as might be prepared by the Auditor for the guidance of the bookkeeper, showing the work that should be done before the audit commences—is appended. Such a list is the following:—

(1) All postings should be completed, all additions inked in, all balances extracted, and the Trial Balance agreed.

(2) Vouchers for all payments should be arranged in order, and available.

(3) A complete list of all books, with the names of the clerks in charge of each, should be prepared.

(4) If possible the cash in hand at the date of closing the books should be paid into the bank, but where this has not been done the cashier must have his books written up to date, and the vouchers ready.

(5) A complete inventory of the stock, priced, extended, added, and duly certified, should be ready.

(6) All bonds, bills, deeds, and other securities should be ready for production when called for by the Auditor, and a list thereof should be prepared.

(7) A list of all overdue accounts, showing the provision (if any) which it is deemed necessary to make against possible loss should be prepared.

(8) A memorandum should be kept of any other matter to which it is thought desirable to call the Auditor's attention.

(9) A draft Balance Sheet and Profit and Loss Account should be prepared.

As has already been pointed out, some of the duties comprised in the foregoing may devolve upon the Auditor in the case of a private firm or trader; but in the case of a company audit it is particularly desirable that these matters should be completed before the Auditor commences his investigation, as it cannot be too strongly impressed upon all concerned that the accounts submitted to the shareholders are *not* the Auditor's accounts, but the accounts of the directors.

CHAPTER III.

SPECIAL CONSIDERATIONS IN DIFFERENT CLASSES OF AUDITS.

IN the previous chapters the rules laid down have been of as general a character as possible ; but it must not, therefore, be supposed that the audit of every concern is to be carried out on precisely the same lines. The opportunities for fraud will vary widely in concerns of a different character, while the chances of unintentional errors in principle and in detail will likewise vary extensively in different classes of concerns.

As has been already intimated, the Auditor who wishes to be of the greatest possible service to his client should avail himself of every opportunity to become practically acquainted with the working of the business, as it will only be when he has some real acquaintance with the matter he is discussing that his opinion upon the accounts of any given business will possess any great weight ; for if he has no knowledge of the business carried on it is impossible for him to intelligently criticise the system of accounts that records the transactions effected, and if he has no knowledge of the nature of such transactions it is hardly to be expected that he should be in a position to form any reliable opinion as to the risk that exists of the transactions not being correctly recorded in the accounts. These remarks will, perhaps, appear trite to many, but so much has been said about Accountants "confining themselves to their own province" that it has become necessary to point

out the utter inefficiency of any audit which confines its investigations to an enquiry as to the academical correctness of the bookkeeping.

The object of the present chapter is not to supply the reader with such special knowledge concerning each class of undertaking as it may be desirable for him to possess before presuming to certify as to the correctness of its accounts—such a knowledge cannot be altogether imparted by any book, and is beyond the scope (as it is beyond the compass) of the present volume—but in the following paragraphs the reader will find his attention directed to those points most worthy of his consideration in each of the leading classes of accounts he is likely to be called upon to verify. The special opportunities of fraud, and the points upon which an innocent misstatement of facts is most likely to occur, will, so far as possible, claim attention; while in Appendix “E” will be found references to books and papers supplying information that is likely to prove useful to the reader—whether practitioner or student.

With these preliminary remarks, the categorical consideration of the subject will be proceeded with.

I. COMMERCIAL ACCOUNTS.—(a) MERCHANTS AND WAREHOUSEMEN.—The chief openings for fraud in these accounts are: theft of stock; misstatement of cash sales; fraudulent payment of bogus purchases; misappropriation of moneys received in payment of accounts—such accounts being either left open or written off as “bad”; petty theft by the raising of fictitious items of discount allowed on receipts, or interest incurred on payments; and similar matters. Of what may be styled “innocent” errors, the most common are errors of principle in the valuation of stock-in-trade; insufficient depreciation on leases and furniture; omission to allow for outstanding discounts and interest; errors of principle in the valuation of foreign currencies; omission of liability on outstanding expenses, and on bills discounted; insufficient provision for bad debts, &c. There are not many trade details that the Auditor will require to be acquainted with in these accounts, but he will do well to ascertain the terms of payment

and discount accorded to, and by, his clients, and to make use of his knowledge continuously. Where the terms vary—and they generally *do* vary—they should be written in red ink at the head of each account in the Ledger. The Auditor should make himself acquainted with the percentage of profit expected by his clients, and should compare it, both with the actual results, and the rate generally realised by others in the same trade. Stock Accounts *can*, almost invariably, be kept by merchants and warehousemen; but this is, in practice, only occasionally done—*verb. sat.*

The question of patents or trade marks sometimes arises in these accounts, but the consideration thereof is more appropriately dealt with in a later chapter.

(b) MANUFACTURING TRADERS.—Under this heading are intended to be included those manufacturers who ordinarily keep a stock of ready-made articles, and who do not manufacture exclusively (or principally) “to order.” Such manufacturers are, clearly, also warehousemen, and consequently the preceding paragraph (a) will apply to the consideration of their accounts; but a few additional precautions are required in connection with their manufacturing departments.

The item of wages, in particular, is one requiring the utmost care; and the question of depreciation of plant and machinery will also require a full share of attention. A proper system of “costing” becomes all but essential. It is probable that the Auditor will find some such system in operation; but it is at least equally probable that the actual system employed will be found both unscientific and unreliable.

(c) RETAILERS.—RETAILERS WHO GIVE CREDIT in many respects follow upon the same lines as the wholesale houses in the same trade; but the increased number of transactions renders a detailed audit more difficult. It is generally quite impossible to call back all the postings of the Sold Ledger; but the *balancing* thereof can be checked without difficulty, and must always be done. Where practicable the posting of the cash received may be checked with advantage, and the

list of balances should always be compared with the Ledger, and the additions checked. Where the business is very voluminous, the audit of the Sold Ledgers is frequently deputed to some of the counting-house staff; but, in any case, the Auditor should not lose his grip of this department, and should occasionally check the balances himself. To check, say, one or two Ledgers at random each year will have all the moral effect of checking the whole set.

Many retail houses supply goods to their own assistants, &c., at reduced rates, and allow credit until the following pay-day. A separate "Assistants' Ledger" should always be kept in these cases, and the Auditor is usually expected to see that the payment of these accounts is not unduly delayed. At every stocktaking he should be careful to ascertain that no amount stands to the debit of an employee who has left.

The Bought Ledger is generally of comparatively manageable proportions; consequently it is rarely impossible to check it *in toto*. In any case the Bought Ledger payments should be checked, both as to postings and vouchers. In a continuous audit it is frequently arranged that the Auditor shall pass all the Bought Ledger statements for payment, and the system has much to recommend it. In addition to seeing that each item on the statements is also in the Ledger, the Auditor should make the Bought Ledger-keeper initial—and so guarantee the correctness of—every statement that is submitted to him. He should also compare the discount deducted with the terms of payment stated at the head of each account in the Ledger. It need hardly be added that this passing of the Bought Ledger statements for payment is not a necessary part of any audit, and—where performed—it should command a special fee.

The vouching of cash received—whether for cash sales or Sold Ledger Accounts—may, under a good system of internal check, safely be left to the care of the staff; but it is the Auditor's duty to see that the receipts are duly banked, and to verify the bank balance. A large Retailers' audit will, almost invariably, be continuous; and it is desirable that the bank

balance, and also the Petty Cash, be examined at least once a month.

The examination of Petty Cash has already occupied attention (*vide* Chapter I.), and it therefore only remains to add that—in addition to securing the *bona fides* of all payments—it is essential that some responsible person be made accountable for the correctness of the dissection of the items.

The Departmental Accounts must not be lost sight of, as they form one of the most important branches of the Auditor's duties. An account showing the sales, purchases, and estimated stock should be submitted to the principals each month, and the preparation of this account frequently devolves upon the Auditor. At the stocktaking the reconciliation of the estimated figures with the actual stock on hand may also profitably occupy the Auditor's attention.

The postings of the Private Ledger should always be called back, and it is highly desirable that such Private Ledger should contain, within itself, all the materials for a Trial Balance.

Bills Receivable will but rarely be found in connection with a retailer's business; but Bills Payable are almost certain to exist, and will require attention.

The vouching of payments for salaries must not escape attention, but it calls for no special comment here.

IN CASH BUSINESSES the problem is somewhat simplified by the considerable reduction effected in the number of Sold Ledger Accounts. Indeed, these accounts are, of course, naturally abolished *in name*; but they remain in essence, as Deposit Accounts kept by regular customers who wish to avoid the trouble of remitting with every order. It is an important part of the Auditor's duty to see that Deposit Accounts are never overdrawn without proper authority.

The system adopted for checking the accuracy of the Cash takings, will, as before, require the Auditor's careful consideration; but, in the absence of any special arrangement to the contrary, it is not necessary for him to carry his investigation

into the accuracy of such takings beyond seeing that the system in use is properly carried out, and that the stated returns are duly banked.

It is very usual for credit notes to be issued against goods returned by customers; and, as these credit notes may be used in payment of subsequent purchases by the customers, or the money therefor obtained upon application to one of the cashiers, the question has to be dealt with by the Auditor. It is generally arranged that, at the end of the day, the petty cashier shall redeem all credit notes in the hands of cashiers, the amounts being charged up through petty cash. The issue of credit notes must therefore be carefully guarded against abuse; and it is essential that the system under which the various departments are debited with their respective returns be properly arranged. The credit notes should always be compared with the counterfoils, and presented to the Auditor for cancellation.

Many retail "limiteds" adopt a similar method for the payment of all dividends under, say, two pounds. In such cases the Auditor's duties are naturally similar to those in connection with credit notes.

(d) CONTRACTORS.—Under this heading the accounts of those manufacturers who keep little or no ready-made stock will be dealt with. This class includes builders, engineers, shipbuilders, &c.

In these accounts the cost of—and profit or loss arising from—each contract will require to be separately stated; the contractor, in fact, opening a special Trading Account for every contract. Cost Accounts thus form an especial feature of the contractor's books, and an inquiry into the principles upon which they are based is thus a most profitable occupation for the Auditor.

The systems upon which Stores are issued, and Wages booked and paid, are also of the greatest importance; and time spent upon such an inquiry is likely to be of considerably

greater advantage to the client than any detailed examination of the books.

The extent of the Auditor's examination into detail will be a matter depending largely upon the nature and magnitude of the undertaking, but also upon his special instructions. A detailed audit would not usually be necessary, as the main points could generally be accomplished by an examination of the Private Ledger; in any case the *leading principles* will be the really important matter.

The same rules which have already guided the Auditor as to the extent of his inquiry into details will serve him here; the larger the undertaking the more its opportunities of internal check, and consequently the less necessity for the skilled Auditor to check every detail. Many large undertakings keep their own staff Auditor, who is responsible for the technical accuracy of the Trial Balance.

The valuation of contracts in hand and the calculation of depreciation are both matters of the greatest importance, but they will be more conveniently dealt with at a later stage (*see under those headings in Chapter VI.*).

(e) BREWERIES.—Although the audit of a brewery is a matter concerning which some experience upon the part of the Auditor is especially desirable, it is by no means easy to indicate, in a few words, the salient features of the task before him.

Theft of stock and of collections are, perhaps, the two main risks run by brewers. The former is best guarded against by properly designed Stock Accounts, and the comparative statistics deducible therefrom, combined with a certain amount of practical knowledge—which latter the Auditor will most likely have to take upon trust from the master brewer. The second risk arises from the fact that accounts are frequently collected by the draymen; the matter therefore requires great care, but it presents no exceptional features. The discounts allowed must not be passed without inspection, however, as they can easily be juggled with.

The Auditor must also see that all rents receivable from Tied Houses are duly accounted for, and the question of depreciation (concerning which the reader is referred to the following chapters) is one of the most important.

The reader will find some useful information upon this subject in HARRIS'S *Brewery Accounts*, but it has not been deemed desirable to pursue the subject at length in these pages.

(f) HOTELS.—The accounts of hotels, whether belonging to companies or to private persons, do not call for any extended comment. The Auditor who is accustomed to Hotel Accounts will be able, by a careful examination of the items comprised in the Profit and Loss Account, to form a fairly reliable opinion as to whether or not any leakage exists. If there appears to be any reason to suspect that things are not as they should be, it might be found desirable to thoroughly examine in detail the charges for a portion, at least, of the period under consideration; but, under ordinary circumstances, it is not usual to carry the investigation *behind* the Bar Bill Book (or Visitors' Ledger) except for the purpose of verifying the Cellar Stock Books. Proper Stock Accounts ought always to be kept of wines, spirits, &c., and these should be carefully inspected, especially if the Profit and Loss Account does not show an adequate return on this department. Where the book-keeper is also the cashier, especial care must be exercised to ascertain that all receipts are properly accounted for; and it is also important to see that the petty cash disbursed upon behalf of visitors has been duly charged to their accounts and collected. The entries in the Tradesmen's, Nominal, and Private Ledgers should always be thoroughly checked; and especial care should be given to the vouching of all payments, including wages.

The question of depreciation—here, as elsewhere—is also a most important one, and must be carefully considered. Such items as Bedding and Linen, Plate, Cutlery, China and Glass, &c., are frequently re-valued for each Balance Sheet, instead of being depreciated regularly; but a better plan is to debit Profit and Loss Account and credit Renewals Account with a

fixed (ample) provision for renewals, the actual expenditure being debited to Renewals Account, and any credit balance treated as a reserve. The advantage of this course is that it equalises profits, so that a period of five years could be averaged; but it is well for the Auditor to satisfy himself that the amount written off against revenue is ample for all ordinary contingencies.

PUBLIC HOUSES follow, in many respects, the same lines as Hotels. The accounts are, in some ways, simpler; but, on the other hand, they are generally less complete. An experienced Auditor may prove himself of considerable value to the proprietor of a public house, but he cannot pretend to protect him against fraud on the part of his employees; neither is it always possible for him to detect any fraud that may have been committed. He can, however, prepare—or superintend the preparation of—accounts that will show exactly *how* the net profit has been earned, and these accounts will suffice the experienced client, for he knows exactly what result ought to have ensued from a given turnover, and so can judge for himself as to the satisfactoriness of the existing management.

(g) CLUB ACCOUNTS.—The accounts of clubs follow very much upon the lines previously indicated with regard to hotels; but there are one or two points with which it seems desirable to deal in a little further detail. In the business of an hotel it is, of course, practically impossible for the proprietors to rely upon their customers to in any way assist them in checking their employees, but, in the case of clubs—and particularly members' clubs, where the members themselves are the proprietors of the undertaking—the accounts can be, to a certain extent, modified with advantage with a view to devising a system by which the members themselves may, to a certain extent, check fraud upon the part of employees.

In many clubs the system obtains of requesting members, after they have paid their bills at the cashier's desk in the coffee room, to place the receipted account in a locked box standing near. The receipted accounts thus form vouchers which can be utilised as the best possible check upon the

cashier himself. In the billiard room, too, it is a very usual custom for members to be asked to place their table-money in a locked box, instead of giving it to the waiter, as is invariably done at hotels; and by this means one of the chief difficulties which arise in connection with hotels is obviated, it being well known that in most hotels the proprietors do not get the benefit of the full earnings of the billiard tables. Other points of a similar description will frequently suggest themselves to the Auditor from time to time. To a great extent they will assist him in making his audit more thorough, and will sometimes enable him to dispense with details of checking which otherwise would be absolutely necessary.

In connection with the cellar, also, the accounts of clubs present an advantage over those employed by many hotels, viz., that all orders for drinks have to be signed by the member and are thus available as vouchers for verifying the taking of wines and spirits out of stock. It may be added, however, that this is a system which is used by a considerable number of hotels, although many dispense with it on the ground that it is difficult to get their customers to take the necessary trouble.

(h) THEATRE ACCOUNTS, ETC.—The most difficult feature in theatrical and similar accounts (from the Auditor's point of view) is the large amount of cash—*i.e.*, coin—which is necessarily handled by all persons connected with the financial part of the arrangement. With the exception of the sums received from the "Libraries," almost all the receipts will be in hard cash; and, on the other hand, it is not infrequent to find that the whole of the amount paid out weekly in salaries and wages is likewise in the coin of the realm. Experience seems to have taught all persons concerned the peculiar charm attaching to a "metallic" currency; and although, from their point of view, there is doubtless much to be said in favour of the system that so generally obtains, the liability to loss—arising from either carelessness or fraud—is sufficient to make many wish that theatrical credit was sufficiently free to permit of a more extended paper currency—in cheques, at least.

An Auditor must, however, above all things be practical; and it is, therefore, well to face the situation at once, and do his best with the existing cash system, for he may rest assured that no amount of "representation" upon his part will induce managers to make all their payments by cheque, while it is, of course, quite impossible that their receipts should be, to any great extent, in anything but cash.

It is not usual for the Auditor to be expected to verify the cash takings; this office is usually performed by the treasurer, or (in a touring company) by the business manager, who is considered a sufficiently responsible person for the performance of a function that requires integrity certainly, but no great technical knowledge. It should be an invariable rule that all sums received are banked at least once a day, and the Auditor will probably find no great difficulty in securing the adoption of this plan. Where this is done the Auditor will, of course, satisfy himself that the amounts so banked agree with the various returns that have been certified by the treasurer. As these returns have not been prepared by the treasurer himself, they form a fairly reliable check upon that official, and—under a properly arranged system of internal check—are sufficient for all practical purposes.

Payments may be roughly divided into three classes—(1) Mounting Expenses, (2) Advertising, (3) Running Expenses, viz., (a) salaries and wages, (b) rent, gas, &c., &c. The first will almost entirely be paid by cheque, against accounts properly certified by the manager, and call for no special comment. The same remark applies to advertising, which, by the way, is almost invariably done by a contractor. Salaries and wages are always paid in cash, usually weekly; separate pay-sheets are drawn up for (1) "Front of house," &c., (2) principals, (3) chorus and ballet, (3a) "supers," (4) band, (5) wardrobe, (6) carpenters, &c. It is a good plan to have separate cheques drawn for each of these headings, and to let every employee sign for the amount paid him. "Supers" do not usually sign for their wages, however, the super-master's signature being generally accepted for the whole amount paid.

(In exceptional cases, however, the salary of some great "star" will be paid into his or her banking account direct; such transactions are, of course, easily vouched.)

The vouching of payments thus resolves itself upon the lines ordinarily adopted in trading concerns; and here—as elsewhere—it is not the least important of the Auditor's functions to enquire into the manner in which the pay-sheets are prepared. It need hardly be stated that all persons entering the premises before a performance sign an attendance book kept at the stage door for that purpose, and that fines for absence or lateness are arrived at from this source. It is not usual for the Auditor to verify the composition of the pay-sheets, but there would be no harm done if he did so occasionally—and unexpectedly.

Advances, or "subs.," are frequently made to members of touring companies (and occasionally also in town companies), and it generally happens that the result is chaos. The Auditor will do well to enquire into the system in vogue as regards "subs.," and to see that it is such that the paymaster (and not the proprietor) loses by any careless omission to recover a "sub." out of the following week's salary.

The valuation of assets, especially of copyright and performing rights, is, perhaps, almost the most ticklish matter in connection with theatre audits; but the subject is so technical that it is necessary to dismiss it with a passing caution against over-valuation. Probably it will be best for the Auditor to expressly state in his certificate that he does not accept any responsibility for the values placed upon these assets.

When a company is "on tour" the usual arrangement is to divide the gross receipts in fixed proportions (generally half each) between the "company" and the provincial lessee, the latter paying rent, gas, &c., also "front of house" and carpenters' wages (sometimes, also, the band), and advertising. The duties of an Auditor acting for either side are thus somewhat reduced. When acting for the representatives, or proprietors, of the touring company he will base his item "gross receipts" upon the joint-certified return of his client's business

manager and the provincial treasurer (who is, not infrequently, stage manager and lessee as well). He must, of course, see that the proper percentage of these gross receipts is duly accounted for. Travelling expenses will usually be arranged with the railway companies from headquarters; and hotel accommodation is not generally provided in theatrical companies. In the case of concert parties on tour it is, however, usual for the management to pay hotel bills: these should be produced to the Auditor as vouchers, but, of course, many incidental expenses must be accepted on the sole statement of the business manager.

Refreshments, and advertising on programmes are usually sub-let; if not, see under HOTELS (I. *f*) and PUBLISHERS (I. *j*) in this chapter.

(*j*) PUBLISHERS.—The audit of Publishers' Accounts presents a peculiar combination of complications. In many cases publishers will do their own printing, and in this respect they follow the rules of manufacturing traders (see under heading I. (*b*) above). Almost invariably, however, they will also be retailers, and hence the considerations detailed under heading I. (*c*) will also apply. Many houses add the further occupation of trading, either wholesale or retail, or both, in the publications of other firms, which, to a great extent, brings them under the heading I. (*a*) above; while almost every house will occasionally undertake the publication of authors' works upon such terms, as to royalty, &c., as make it absolutely necessary that both Stock Accounts and Cost Accounts should be carried to perfection. In this respect Publishers' Accounts involve many of the considerations discussed under heading I. (*d*) when dealing with Contractors' Accounts.

A complete audit of Publishers' Accounts is, on account of the multiplicity of detail involved, a practical impossibility; the extent to which a partial audit may advantageously be carried must, on the other hand, of necessity vary with almost every individual case. The considerations involved in the previous paragraphs are the only ones that can be offered here.

Advertisements inserted in books, and also in magazines, are a source of income that must not escape attention. It frequently happens that the whole space has been sold out-and-out to an advertising contractor, which will naturally simplify the Auditor's work to a great extent; where, however, a firm of publishers runs its own advertising department—an unusual occurrence with books, but not an infrequent practice with magazines and reviews—the procedure follows that of the Newspaper audit, which will be considered next. As to how far the Auditor need go into detail here, must again be left greatly to his own discretion and the circumstances of the individual case.

Permanent assets, such as buildings, plant, &c., must, of course, be subjected to proper depreciation, and Stock-in-Trade will require carefully valuing. It ought to be possible for the Auditor to obtain absolute proof as to the *quantity* of Stock-in-Trade, but he can hardly be expected to check the inventory *in extenso*. The prices set upon unsold publications should never exceed the cost of production; and, in the case of periodicals at least, only a certain number are really worth more than waste paper price.

With regard to the valuation of copyrights for Balance Sheet purposes, it is usual for a separate account to be opened for each publication, which is, in the first place, debited with the actual cost of production, including, of course, the printing, binding, illustrations, &c., or (where the copyright is purchased from another house) the purchase price thereof, together with that of any stock which may have been taken over. Many firms, at balancing time, review the debits to the various Copyright Accounts, depreciating some and appreciating others; that is to say, the system is adopted of valuing the copyrights by inventory at each period of balancing, wholly irrespective of the actual cost. It is, of course, very desirable that where necessary the cost should be written *down* from time to time; but the arguments in favour of writing up the value of a copyright are precisely those which might be—and, indeed, should be—invariably used against writing up the value of the asset Goodwill and crediting the difference to Profit and

Loss Account. It may be perfectly true that a large revenue is expected from this asset in the future, but that, in itself, can afford no possible argument for anticipating that revenue, and taking credit for it in the current period. On the other hand, it will probably be generally admitted that no great harm can be done by writing up such copyrights as have appreciated, so long as the actual effect of so doing is not to increase the book value of copyrights as a whole. In this connection it may be mentioned that with many houses there is a good general rule in use, to the effect that the value attached to any copyright should not exceed three years' purchase upon the gross profit earned therefrom during the past year.

Sometimes, even when a publication is itself a failure, some residual value will attach to woodcuts, plates, &c., which have been used in its production. It is very important, however, that no fictitious estimate should be put upon the value of such doubtful assets as this, and of the two it seems infinitely preferable that they should be stated at *nil* in the Balance Sheet.

The value of artists' original drawings (for illustrations) is often considerable, and has not infrequently been found to exceed the price originally paid for both original and copyright; it is hardly safe, however, to reckon such originals as assets—if valuable, they will generally be sold, and if not sold they confer no benefit on the business *as originals*. Care should be taken to ascertain that the Stock List is not unduly inflated by almost entire editions of absolutely unsaleable publications that are not worth anything like the cost of production.

On behalf of his clients it may be thought desirable for the Auditor to thoroughly check all Royalty Accounts, but this does not form part of a regular audit.

NEWSPAPERS and PERIODICALS present a few special features. In the absence of a staff-auditor, the Auditor will require to satisfy himself that every advertisement is eventually paid for (unless, of course, a bad debt has been made), or else that it has been franked as "free" by some responsible

person. The Commission Accounts of agents and canvassers should also always be examined.

The "inside" of a paper is the work of the regular staff, or of "contributors"; the former are paid a regular salary (usually), the latter are paid for the actual work done. It would be a desirable thing to make sure that a contributor was never paid for a sub-editor's work, but no Auditor could ever ascertain such a thing for himself, and he must, therefore, rest content with the certified Contributors' Accounts as they are submitted to him.

It frequently devolves upon the Auditor to prepare weekly, or monthly, statements, showing approximately the income and expenditure. Such work naturally commands a special fee.

The printing of the publication calls for no special comment here; when done by the proprietors they will, of course, be printers, as well as publishers, and the Auditor must take his stand accordingly.

The number of copies printed, issued, returned, exchanged, distributed free, and in stock, should always be certified by the publishing manager. From his returns the Trade Ledger debits may be vouched.

Every periodical is started at a loss, and it is usual to debit this loss to an Establishment Account; when the concern pays—and so acquires a goodwill—the cost of such goodwill is represented by the amount to the debit of Establishment Account, which thus virtually becomes a Goodwill Account. There is no great objection to this system, and it is much in favour on account of the information it affords to the intending purchaser of a recently established paper; but, when a periodical is once fairly started, the Auditor should require a very good reason to be furnished him before he sanctions the transfer of an unexpected loss to the Establishment Account: if such loss arises from an increase of matter (in quantity or quality) or a reduction in price, it may be in the nature of capital outlay, as tending to increase the permanent value of the concern, but an *unexpected* loss is likely to have the contrary effect.

II. MINING ACCOUNTS.—(a) COLLIERIES.—Better advice can hardly be given to the Accountant who is about, for the first time, to audit the accounts of a colliery, than to suggest that he should make a tour of the whole works (both above and below ground) in company with the colliery manager. If he be of an observant turn of mind he will probably, by the end of his inspection, have formed at least some idea of the scope of the undertaking, and he will doubtless find that the gloom of the underworld has thrown considerable light upon the records kept above ground. Even the Auditor experienced in Colliery Accounts will probably find that the thorough inspection of a new mine is really a wise economy of time; in fact, whatever the nature of the business may be, the Auditor who acquaints himself with the manner in which it is carried on does wisely.

A question of particular importance in these accounts is the treatment of the Capital Expenditure Account. Great care must be taken to see that no expenditure properly chargeable against Revenue is included herein—indeed, it is always desirable to get the Capital Expenditure Account altogether closed as quickly as possible.

The item "Minimums paid in excess of royalties earned," which frequently occurs as an asset in the accounts of young collieries, requires some little explanation. The royalty payable is based upon the quantity of ore extracted—usually upon the number of tons, but sometimes upon the number of cubic yards of the acreage of the seam's works—a fixed minimum, or dead, rent being payable in any event, whether the mines are worked or not. During the sinking of the shafts and first working of the mine, therefore, the rent paid naturally exceeds the normal percentage upon the output. Under ordinary circumstances this would represent a charge against Revenue in the usual way; but, as the lessees are empowered to recoup themselves out of subsequent raisings, it is quite justifiable that the excess so paid away at first should be carried forward as a set-off against the output of later years. It is very necessary, however, that the Auditor should examine the constitution of the

amount so carried forward. It not infrequently happens that the mine as a whole is comprised of several leases, some of which not only are not being worked, but never will be; the minimum rent upon such portions ought, of course, to be charged against Revenue each year, and where, in the early days of the colliery's existence, an accumulation of such minimums has been allowed to be carried forward, it must be written off as soon as possible. Again, there is usually a limit to the time during which over-paid royalties may be recouped, and this limit, of course, must not be exceeded.

It has been thought desirable to append *pro formâ* accounts, showing what is regarded as the best and most compact method of dealing with royalties and minimum rents in the accounts of collieries and similar undertakings. In this example it is assumed that the fixed (or minimum) rent is £300 per annum, and the royalty 1s. per ton upon the output; the amount of ore raised during the three years covered by the example being 400 tons, 2,000 tons, and 35,000 tons respectively.

Dr.		ROYALTIES ACCOUNT.		Cr.	
(1) To Landlord	£ s d	(1) By Profit and Loss..	£ s d		
	20 0 0		20 0 0		
(2) To Landlord	100 0 0	(2) By Profit and Loss..	100 0 0		
(3) To Landlord	1,750 0 0	(3) By Profit and Loss..	1,750 0 0		

Dr.		LANDLORD'S ACCOUNT.		Cr.	
(1) To Cash	£ s d	(1) By Royalties	£ s d		
	300 0 0	(1) " Redeemable Dead Rents	20 0 0		
		Account	280 0 0		
	£300 0 0		£300 0 0		
(2) To Cash	300 0 0	(2) By Royalties	100 0 0		
		(2) " Redeemable Dead Rents	200 0 0		
	£300 0 0	Account	£300 0 0		
(3) To Redeemable Dead Rents		(3) By Royalties	1,750 0 0		
Account	480 0 0				
" Cash	1,270 0 0				
	£1,750 0 0		£1,750 0 0		

Dr.		REDEEMABLE DEAD RENTS ACCOUNT.				Cr.					
(1) To Landlord	£	s	d	(3) By Landlord ..	..	..	£	s	d
(2) " Do.	280	0	0				480	0	0
			200	0	0						
			<hr/>						<hr/>		
			£480 0 0						£480 0 0		
			<hr/>						<hr/>		

It need hardly be added that the only justification for treating the whole, or any portion, of the balance of the Redeemable Dead Rents Account as an asset is the reasonable probability that it will be redeemed out of future workings within the time limit allowed by the lease.

The question of Depreciation upon Mines is naturally one of no slight importance; but it would appear that—however desirable it may be that an adequate provision should be made for depreciation arising either from the exhaustion of minerals, or from the lapse of the lease, or from both—it is not legally necessary even for a mining *company* to set aside any portion of its earnings to replace wasting capital. The Auditor can thus do no more than advise the extreme desirability of so prudent a course.

DEPRECIATION OF PLANT should, of course, be provided for; but that question is best dealt with in the following chapter, where, also, the proper mode of treating wagons on the hire-purchase system will be duly considered.

BRICK WORKS.—It is a matter of constant occurrence for a colliery to own brickfields, and it is by no means uncommon to find that it owns the cottages occupied by its workpeople. Both these matters will require the Auditor's attention, but they need not be considered at length here. Chapter II. has already dealt with the question of rents receivable, while the accounts connected with brick-making call for no special comment, beyond the mention that proper Cost Accounts must be kept.

THE WAGES paid at collieries require the same careful attention that must at all times be accorded to that most important item; but inasmuch as the great bulk of wages paid is at the

rate of so much *per ton*, the aggregate amount payable can be tested with greater facility than in many cases.

The peculiar conditions obtaining to Colliery Accounts generally render it desirable that the audit should descend into somewhat considerable detail; concerning the actual extent of such detail, however, no general rules can be given, as each case must be judged upon its own merits.

COMPARATIVE STATISTICS of Colliery Accounts will be found of the greatest help to the Auditor, who should not fail to learn their use and value.

(b) FOREIGN MINES.—To a very great extent the foregoing considerations apply to mines of every description; but the circumstance of a mine being abroad naturally modifies the procedure in certain respects.

It is not usual for the Auditor to visit the works of a foreign mine. The general manager remits periodically a certified return of his payments and receipts (if any), which is incorporated in the accounts kept at the head office. Such accounts are not usually very voluminous, and are generally examined by the Auditor *in toto*. It is, of course, desirable that all expenditure at the works be properly vouched, and for the Auditor to examine these vouchers. To make such an examination really effective, some knowledge of the language locally spoken is, of course, highly desirable; but it is no use for Auditors to conceal (from themselves) the fact that, with regard to foreign expenditure, they are largely in the hands of the general manager, who—up to a certain extent—might rob his employers with impunity, if he so chose.

For Balance Sheet purposes the general manager should be required to apportion all expenditure between Capital and Revenue, and to certify such apportionment; also to submit a certified statement of local floating assets and liabilities, or a certificate that no such assets or liabilities exist locally, and at the same time he should report upon the state of efficiency of the plant and machinery, together with any buildings and other more or less permanent assets there may be upon the

works. This latter report is most essential for a proper consideration of the question of depreciation:

The reader who may wish for information with regard to the returns which should be made by the mines manager to the head office will find much that is of interest in Donald's *Accounts of Gold Mining and Exploration Companies* (*vide* Appendix "E.").

It is always well—and where the produce of the mine is precious, it is very essential—for the Auditor to use every available means of ascertaining that credit has been taken in the books for the value of the whole of the output. In conclusion, it may be added that he should expressly state in his certificate what the precise extent of his examination has been.

(c) MINES UNDER THE STANNARIES ACTS.—It is not usual for the services of professional Auditors to be requisitioned in these cases; but as the Cost Book System under which the Cornish mines are worked is one peculiarly suitable for mining accounts, and as, moreover, the system is not generally known, it has been thought well to state briefly the outlines of its working. Auditors will find it may (so far as legally possible) be advantageously applied to the working of any metalliferous mining syndicate.

The owners of a mine are practically unlimited partners, with power to transfer their shares without the consent of their co-partners, or to withdraw altogether upon payment of their share of the current liabilities. No partner is liable for the mine's debts, after he has sold or relinquished his share in the mine.

The capital is unlimited. At the commencement it is usual to call up what is considered to be sufficient working capital for the next three months, and thereafter a general meeting must be called at least once in every sixteen weeks. At every meeting an account of receipts and payments and a detailed Balance Sheet must be submitted. If there be a surplus the members are to decide whether the whole or any (and if so,

what) portion thereof shall be divided. If there be a deficit, a call should be made, sufficient to meet all outstanding liabilities, and to provide further working capital for current needs.

There are two methods of paying the miners. "Tributers" are placed on a definite pitch, and are paid a certain agreed proportion of the value of the metal raised by them. Contracts with Tributers are renewed every eight weeks, and their earnings naturally vary very considerably. As they have to pay for candles, dynamite, fuses, tools, &c., they may even find themselves indebted to the mine at the end of their eight weeks' contract; on the other hand, their earnings are sometimes very high. The other method of payment is by "Stoping," under which the miner is paid so much per ton for all stuff (earth and ore) sent to the surface: under this arrangement a miner's earnings are very regular.

In Appendix "A" will be found certain extracts from the Stannaries Acts relative to accounts under the Cost Book System. The Stannaries Court, which was established in the reign of Charles I., was abolished in 1896, its jurisdiction being transferred to the County Courts.

III. FINANCIAL ACCOUNTS.—(a) BANKS.—In dealing with the question of Bank Audits, it is well to remember that one of the most controversial subjects relative to professional practice is being discussed. So far 'as possible, a position that few will care to assail will be occupied; but it were well to admit at once that the author considers the duties of a Bank Auditor to be very much more responsible than some eminent Accountants care to admit, whatever his bare legal responsibilities may be. It is not necessary to criticise the motives that have dictated the position taken up by some of the leading members of the profession; but it is difficult to see the force of an argument that virtually amounts to the assertion that the mere multiplicity of a series of statements is a valid reason for not enquiring into the accuracy of those statements, or into the desirability of the existence of the facts which they indicate. Further, it is to be remembered that the

bare legal responsibility is not the highest measure of the duties of a professional man. It is certainly very desirable that the law should not be unduly harsh—or the position of an Auditor would be intolerable—but it is imagined that few would consider that they had discharged all moral obligations as soon as they had complied with their statutory duties. These remarks, however, would seem to apply equally to all classes of audits.

Under the Companies Act, 1862 (section 44)—for which see Appendix “A” to this volume—limited banking companies are required to exhibit a statement of their affairs. It were well, therefore, for the Auditor to see that this section is complied with, and that the statement so exhibited is correct.

In the Companies Act, 1879 (the relevant sections of which are also reprinted in Appendix “A”), various provisions occur with regard to the Auditor’s duties, which must not escape the attention of the Auditor of a banking company registered under that Act. The Court of Appeal has decided (in the *London and General Bank* case) that an Auditor appointed under the 1879 Act is an “officer of the company” within the meaning of the Companies (Winding-up) Act, 1890.

One of the provisions of the 1879 Act is that the Auditor shall be furnished with a list of all the books kept by the company, and it is not at all a bad plan to ask for this in other cases besides banks. At the trial of a defaulting bank manager some five or six years since, it transpired that such a list had never been furnished to the Auditor, and that the books that would have revealed the frauds were likewise kept back. The matter provoked some correspondence at the time, but the moral is so obvious that it need not be enlarged upon here.

The certification of a Bank Balance Sheet involves the thorough examination and exhaustive testing of every account in the General Ledger, the counting of the balance of cash in hand, the examination of all bills (especial care being taken to note that all overdue bills are properly explained, and that rebate of interest is duly allowed for at a uniform rate), and

the inspection of all securities—in which latter task it is usual for the Auditor to receive the advice and assistance of the Solicitor. With regard to the counting of the cash balance, the only safe way of dealing with cheques in hand is for the Auditor to himself forward them to the clearing house and other agents. The disregard of this precaution has left the door open for most serious frauds upon the part of bank managers and others.

In connection with the inspection of securities, it is, perhaps, well to call attention to the extreme importance of *all* the securities being produced simultaneously, and of their all remaining in the Auditor's sole keeping until the inspection of all is completed. Extensive frauds have been known to remain undetected through a failure to observe this simple precaution.

How far the Auditor should extend his examination of the customers' accounts is a matter concerning which considerable difference of opinion obtains; but many will endorse the *dictum* of the late Mr. SLOCOMBE, that "the overdrawn balances due from customers should be carefully scrutinised—more particularly those which are not secured, or, being secured, have exceeded the limit fixed by the Board of Directors; and I need not add here that one important part of the Auditor's duty, after making this examination, is to see that, in his judgment, ample provision has been made for the losses likely to arise upon them."

This point suggests the consideration of secret reserves, which have been attacked upon the contention that, by their very existence, they proclaim the fact that the Balance Sheet is not "full and fair." Assuming, however, that the secret reserve is merely a *bonâ fide* provision against unforeseen bad debts, the author fails to appreciate the crying need for the publication of the amount of the provision made. Unless the amount is so separately stated, however, the *only* proper method of dealing with it is to deduct the amount of the reserve from the assets against loss upon which it has been accumulated. Any such reserve as is implied by the omission of such tangible assets as office premises from the Balance Sheet can only be

regarded—and this is stated deliberately, and in spite of the prevalence of the custom—as incorrect and misleading. Moreover, it possesses the practical disadvantage that the very existence of such assets may be concealed even from the Auditor, and thus fail to be examined along with the rest of the securities.

Perhaps the chief difficulty in the audit of a large bank consists of the great number of its branches; of the English banks alone, eight have over 100 branches. It is expressly provided in the 1879 Act that the Auditor need not examine the accounts of any branch beyond the limits of Europe; this provision certainly relieves the Auditor, so far as it goes, but it is distinctly suggestive of an intention, on the part of the Legislature, that the accounts of all European branches *should* be examined by the Auditor. The difficulty in the way of such an examination in the case of the largest banks must be at once apparent, for obviously it is of but little use for the Auditor to check the cash balances at the various branches unless the checking is conducted simultaneously. It is believed that only one large bank (the Metropolitan) submits all its branches to the accountant's audit; still, the existence of a single instance seems to show that the requirements of the statute are not altogether impossible. It is clearly desirable, where an examination of all the branches has not been made, that the Auditor's certificate should be so framed that there may be no misapprehension upon this point.

A detailed audit extending to all the transactions of a bank is not practicable, nor—in view of the very highly developed system of internal check employed—is it necessary. The branch managers and branch inspectors must perforce be relied upon to a very great extent, and—except in the very rare instances of conspiracy between them—it is thought that they may be safely depended upon. Here, as elsewhere, however, a knowledge of men and matters is most valuable, and the Auditor should not dismiss this question of possible dishonesty from his mind until he has reasonably satisfied himself upon the point. These remarks are in direct contradiction to the

view expressed by Lord (then Mr.) Justice VAUGHAN WILLIAMS in the *New Oriental Bank* case (*vide* Appendix "B"), but it is believed they will be considered practical by many whose authority upon such matters is perhaps even greater.

It is not usual for the Auditor to examine all the customers' Pass Books, but he should see that they are frequently examined by the manager or the inspector, and at the close of the year that every Pass Book has been examined and initialled by one or other of these officers. It will be noted that, later on, in the case of Building Societies and Trustee Savings Banks, it is laid down as an essential that all Pass Books should be examined by the Auditor: the distinction between the two cases lies in the vastly superior system of internal check adopted by banks.

A plan that is sometimes adopted, and which has much to recommend it, is for the bank to send a statement to every customer, showing the amount to his credit (or debit) at the time of balancing, and requesting him to sign and return the same, if correct. The system is, however, not very usual, and, apparently, when tried has not always been found effective, owing, doubtless, to the unfortunate, but none the less well-known, disinclination of the general public to co-operate with any business undertaking in any reasonable system of check upon the honesty of employees.

In dealing with Bank Accounts, and all other accounts of a similar nature, the Auditor must never forget that his responsibilities are not confined to safeguarding the interests of the proprietors. His certificate is virtually—whatever it may be legally—a guarantee *to the public* that the accounts submitted are to be relied upon as being, in every respect, correct. It is not, of course, suggested that he guarantees the safety of the customers' deposits; but he would reasonably be blamed were it to transpire that a bank which he had certified as solvent was afterwards discovered to be hopelessly insolvent.

At first sight it may appear impossible for the Auditor to act up to the position here indicated, but he must remember

that, in reality, *the* test of an Auditor's competency is in his ability to judge of the correctness of items by an exhaustive testing—not necessarily of the items themselves, but of their totals. Mr. J. SUGDEN STOCKS, whose experience of Banking Accounts is considerable, has given it as his opinion that “an Auditor, in a comparatively short time, may go through the books of a bank, and satisfy himself as to its thorough stability, without having—as someone has said—to take his seat in the bank parlour and continue his investigations through the whole year.” It need hardly be added, however, that a knowledge of banking theory and practice will be found an all but essential aid for this purpose.

The foregoing quotation would seem to imply that Mr. STOCKS considers an annual audit sufficient; but the author considers that a bank audit—to be really effectual—should be more or less continuous, for it is extremely difficult for the Auditor, who is not frequently on the spot, to get any extensive insight into the manner in which a business is carried on.

A few remarks concerning the Revenue Account will not be out of place. The items of interest constituting the gross profit must be carefully tested, especially as to the rate charged upon current transactions, and also interest taken credit for upon doubtful advances will require the most careful consideration. With regard to the rebate upon bills in hand, it has already been stated that this should be at a uniform rate; by this, however, is not meant that the rate must necessarily be a fixed one—some banks employ a fixed rate (generally 5 per cent.), while some employ the rate actually charged in each case; and some, again, the current market rate. The first and third methods possess the merit of simplicity, but perhaps the second is the most strictly accurate. The great thing for the Auditor to observe, however, is that one method is uniformly adopted, otherwise the profits of the year might easily be manipulated.

In the foregoing remarks the desirable extent of the Auditor's duties has been stated, rather than the bare limits of his legal responsibilities; the question will, however, be found very fully discussed under the heading of “The Liabilities of Auditors.”

(b) INSURANCE OFFICES.—It will be convenient to deal first with Fire Offices, and to afterwards consider the various modifications necessary for the audit of other Insurance Accounts.

FIRE OFFICES.—The first point appears to be for the Auditor to satisfy himself as to the total amount of income receivable. The Policy Book and the Renewal Register—modified by the Specials and Endorsement Books—will provide him with this information; but a large amount of tedious (although most necessary) checking of additions must be done before the result is finally arrived at. Where renewal receipts are written out for *all* existing policies, the production of all unused receipts should be required as a voucher for policies discontinued; but where blank receipts are used—either in the head office, or at the branches or agencies—the number of receipts issued, used, and returned, must be compared with the number of renewals and discontinuances, allowance being made for such receipts as have been spoiled.

It is not necessary for the premium income to be checked in detail; the gross amount receivable is known, and the insurances discontinued can be verified, the net amount receivable can thus be arrived at. The total cash received on account of premiums, less the outstanding balances at the commencement of the period, will agree with the net amount receivable, less the balances outstanding at the close of the books. A list of these latter will be furnished to the Auditor, which he can easily check by satisfying himself that they have either been actually received since the closing of the books, or have been acknowledged by the agents to have been received by them. This is a much smaller affair than checking each item received, but it is—if anything—more exhaustive.

Re-insurances will, of course, require due examination, but they call for no special comment.

The Cash Book must be carefully added and properly vouched, and it is well to check the vouching of all miscellaneous receipts in detail. It is not usually a very long job, and cannot well be verified in any other way.

With regard to losses, it is not usual—unless the amount is large—to go behind the voucher for the receipt of the amount paid; the directors who signed the cheque are supposed to have satisfied themselves (and to have undertaken the responsibility) concerning the *bona fides* of the claims allowed. The postings of the Cash Book should, however, all be checked. It is well to call for the Claims Book, with a view to making sure that due provision has been made among the liabilities for all claims received in respect of losses incurred up to the date of balancing.

The valuation of the Balance Sheet assets is more appropriately considered in the next chapter, while the method of verifying the items is similar to that obtaining under Banks and kindred associations.

The percentage of premium income to be carried forward as a provision against unexpired risks must not be lost sight of. From 30 to 33 per cent. is the usual allowance; if a smaller amount be reserved, the effect is that the company is not setting aside a sum that would be sufficient to enable it to re-insure against the whole of its liabilities under current policies. It is not usual to make any *special* reserve for this purpose: in general, the provision is included in the reserve fund. Such a practice is not strictly correct, however, for a reserve fund should represent an accumulation of pure profits, while a reserve for unexpired risks is a provision for profits as yet unearned. Still, the practice is so general that it can hardly be described as misleading.

Another similar item that must not be forgotten is that of premiums paid in advance. Where a reduced premium is accepted for, say, seven years' premium paid in advance, the question of interest ought really to be considered; but, as these transactions are not generally very numerous, interest is not usually provided for.

The item "Premium Income" should always be stated "less Re-insurances," both for the sake of showing the net revenue of the company and for calculating the provision for unexpired risks.

The accumulated reserves of a sound company should always amount to at least one year's net premium income—in some of the best offices they run as high as two years' income.

LIFE OFFICES are governed—so far as the form of their accounts is concerned, and in many other respects of less immediate interest to the Auditor—by the Life Assurance Companies Act, 1870, and the amending Acts of 1871 and 1872. The material portions of these Acts are included in Appendix "A," and should, of course, be thoroughly mastered by the Auditor before commencing his work.

Where the office also carries on other insurance business, it will be noticed that the accounts are required to be kept separate, and the Auditor will naturally have to see that this is done—not merely on paper, but in very fact.

Every three, five, or seven years (as may be required by the constitution of the company) a "valuation" Balance Sheet will have to be prepared. The distinguishing feature of these periodical accounts is, of course, the actuarial valuation of the office's liability to the policy-holders. The Auditor is not responsible for the accuracy of this valuation, but it is his duty to see that the accounts are duly prepared in accordance with the actuary's figures.

The routine of the audit will differ but little from that of the Fire Office, but the Auditor will be wise to pay particular attention to the surrenders. Claims should also be more carefully looked to than is necessary in Fire Offices.

The audit of the investments will be a much more voluminous matter than before, and will require considerable care, both to see that the capital is intact and that the prescribed income has been received. As, however, the method of keeping Investment Ledgers varies very considerably with different offices, this matter cannot well be gone into in further detail.

In some cases the Auditor of a Life Office will have been appointed especially to protect the interests of policy-holders. In every case, however, the Auditor should consider himself

responsible to the policy-holders for the correctness of the accounts, which he should on no account unqualifiedly certify, unless he is convinced of the stability of the undertaking.

ACCIDENT, GUARANTEE, AND OTHER OFFICES do not raise any new considerations. The great majority of such accounts follow entirely upon the lines of Fire Offices—the company's contract being an annual one, which they can discontinue at any time, should they think well to do so. The business of SICKNESS ASSURANCE, however, more nearly approaches that of a Life Office, and actuarial assistance will be required for the determination of the value of the unexpired risks. The problem being a comparatively new one, no special legislation has, as yet, been enacted relative to Sickness Assurance Offices.

GENERALLY, readers may be referred to the remarks concerning "Branches" under the head of "Banks." The amount of audit bestowed upon the various branches of Insurance Offices is often by no means sufficient; but, on the other hand, the internal audit is usually fairly satisfactory, while that in force at the head office is, often as not, most conspicuous by its absence.

It is but right to add that many insurance offices are incorporated either by special Act of Parliament, by Deed of Settlement, or by Royal Charter. This circumstance, however, while naturally affecting the internal arrangements, does not, practically, influence the Auditor's duties in any material way.

(c) TRUST AND INVESTMENT COMPANIES.—The accounts of these companies are, probably, as simple as accounts can well be. The ostensible purpose of such companies is to enable investors to spread their capital over a large field, and so, by the principle of average, obtain a better security for their principal without a corresponding sacrifice of interest.

How far the Trust Companies of the day have acted up to this theory of their existence, it is beyond the present purpose to enquire. Suffice it that, from the shareholder's point of

view, the only satisfactory accounts will be those which indicate a fair rate of interest earned without depreciation of capital.

The Auditor will require to see Brokers' Contract Notes for all sales and purchases, and also to ascertain that all dividends and interest have been properly accounted for. Purchases *cum div.* and sales *ex div.* will probably be the most likely cases in which an irregularity may occur.

The valuation of investments is perhaps the most important function of the audit of Trust Companies. Under the existing unsatisfactory state of the law, the Auditor cannot, it is believed, prevent the directors issuing accounts stating investments at cost price (regardless of value), but he at least can—and certainly should—call attention in his certificate to anything that he considers to be an undue inflation of assets.

It is not always imperative that investments should be written down to market price. In the first place, the principle of averages may consistently be followed here, and it will suffice if the total market price be not less than the total cost price. If, however, there be a deficiency in this respect, it should be met, not by a revision of individual values, but by a setting aside of a lump sum to an Investment Fluctuation Account as a reserve against loss. This reserve may either be deducted from the amount of investments in the Balance Sheet, or separately stated as a liability. A reserve so created should, except in very special cases, not be reduced in subsequent years, except for the purpose of providing for the actual loss realised upon the sale of depreciated investments.

When the total market value exceeds the total cost price it is not at all desirable that the capital value of the investments be increased. Such a margin is much better kept in hand—at all events until the permanence of the increase be well assured—as a secret reserve, against which the company may draw in bad times.

With regard to the profits or losses arising from sales made during the period under audit, in the first place the dividend should be apportioned (from day to day) so that the actual

capital profit or loss may be arrived at. Such profits and losses made during any one year should be treated in the aggregate; if the result be a profit it is available for dividend; if a loss be the result, it must come out of revenue, unless there exist an adequate reserve from which the loss may be taken. It is, however, highly desirable that profits made by changes of investments be taken to reserve, and not credited to revenue.

In bad times the conscientious Auditor of Trust Companies has an unthankful task before him, but he must not shrink from the responsibilities of his situation.

What has been written above appeared in the first edition of this work, when Trust Companies were still in their infancy. It does not seem, however, that more recent events in any way affect the general principles laid down with regard to the manner in which a Trust Company may be soundly conducted. The past years have, in point of fact, proved exceptionally trying to many of the Trust Companies that were in existence when the first edition of this work appeared, and it may be added that the causes of the downfall of the majority of those companies that failed, or were reconstructed during that period, are to be found in their disregard for the principles of sound finance which have been already enumerated.

It has throughout been the general scheme of this work to lay down the lines upon which an audit may be best conducted, rather than those upon which it may be conducted without personal risk to the Auditor himself; but for the sake of completeness it is desirable to call attention to the fact that it has been decided by the Court of Appeal in the case of *Verner v. Commercial and General Trust* that a pure Trust Company may by its articles of association provide that all sums received as interest or dividends upon investments, less administration expenses, are profits available for dividend, without taking into consideration any depreciation or loss arising from fluctuation in the value of the capital assets of the company. The judgment of the Court of Appeal, and also the judgment of Mr. Justice STIRLING in the Court of first instance, will be found

duly recorded in Appendix "B"; it may, however, be added at this point that the view taken by the Courts seems to be that it is quite competent for a company to so constitute itself that its members are, for all practical purposes, in the same position as life-tenants would be in the case of an ordinary trust; that is to say, they are to receive whatever income is earned (less current expenses), without any reduction in respect of losses of capital or any accretion in respect of gains. Of course, in the case of an ordinary trust the field of investment is expressly limited to first-class securities unless the instrument creating the trust enlarges the field. In the case of a Trust Company the instrument creating the Trust is the memorandum of association, and if sufficiently wide powers are contained in the memorandum it seems to be possible for the company to invest in the most speculative concerns without making any provision for possible or ascertained losses so long as creditors are not defrauded thereby. The decision is in itself sufficiently dangerous, even when expressly limited to a pure Trust Company; but when the decision comes to be further extended, the expediency of following it becomes even more doubtful. In Appendix "B" will be found a report of Mr. Justice STIRLING's judgment in the case of *Wilmer v. McNamara & Co., Lim.*, which is founded upon the decision just stated, but further extends it, so far as the Court declined to interfere in the distribution of a dividend declared in the case of a trading company, notwithstanding the fact that it was not satisfied that a sufficient sum had been set aside to meet the depreciation that had actually occurred in the wasting assets. Should such a decision as this be upheld upon appeal, it would almost appear as though the setting aside of depreciation was an entirely voluntary act which could in no case be enforced upon a company against the will of the majority; but the truth of the position seems to be that this case—and, for that matter, many other similar cases—has not been properly understood either by the counsel or by the Courts, and it is very doubtful whether the principles that have been laid down in these two cases would be upheld if the direct consequences of these decisions were properly represented to the Court.

To sum up, therefore, it appears that there is still grave doubt with regard to the legal possibilities of a Trust Company declaring dividends in the face of a shrinkage in the value of capital assets; and although, so far as the authorities have hitherto gone, it would appear that under some circumstances such dividends may be legally declared, it is, on the other hand, certain that the declaration of such dividends is a direct violation of every principle of sound finance, and should at all times be discouraged by the Auditor, who should make sure that the true position of affairs is sufficiently revealed to the shareholders, either upon the face of the accounts or by a special clause included in his certificate.

CHAPTER IV.

SPECIAL CONSIDERATIONS IN DIFFERENT CLASSES OF AUDITS.

(Continued.)

IV. GAS AND WATER ACCOUNTS.—(a) **GAS COMPANIES.**—It is not essential that a Gas Company be incorporated under special Act of Parliament; but, as it can by no other means obtain power to pull up roads for the purpose of laying down or taking up mains, &c., it is very unusual to find a company of any importance not so incorporated. In such cases, however, as do exist, the company is under no special statutory obligation with regard to its accounts, but in general respects the Auditor's duties will be the same as those of the Auditor of a company incorporated under a special Act.

In the case of a Gas Company especially incorporated, it is, of course, necessary that the Auditor should make himself thoroughly acquainted with the particular Special Act; in it he will find provisions as to share and loan capital, the rate of dividend or interest to be paid thereon, the standard price of gas, and other particulars which will have to be borne in mind. He will also find certain General Acts incorporated with the Special Act, and with these he must make himself thoroughly acquainted in so far as they affect his duties.

The General Acts above referred to are as follow :—

The Companies Clauses Consolidation Act 1845.

The Land Clauses Consolidation Act 1847.

- The Gas Works Clauses Act 1847.
- The Town Improvement Clauses Act 1847.
- The Sale of Gas Act 1859.
- The Sale of Gas Amendment Act 1860.
- The Metropolis Gas Act 1860.
- The Land Clauses Consolidation Amendment Act 1860.
- The Metropolis Gas Amendment Act 1861.
- The Companies Clauses Act 1863.
- The Sale of Gas (Scotland) Act 1864.
- The Companies Clauses Act 1869.
- The Gas and Water Works Facilities Act 1870.
- The Gas Works Clauses Act 1871.
- The Municipal Corporations (Borough Funds) Act 1872.
- The Gas and Water Works Facilities Act 1870 Amendment Act 1873.
- The Conspiracy and Protection of Property Act 1875.
- The Public Health Act (Gas Supply) 1875.
- The Burghs' Gas Supply (Scotland) Act 1876.
- The Lands Clauses (Umpire) Act 1883.

Those sections of the above Acts that refer immediately to the Auditor's duties, or to the form of the Accounts, will be found reprinted in Appendix "A."

The form of accounts given in Schedule B of the Gas Works Clauses Act 1871 applies to all companies whose Special Act incorporates either the 1871 Act, or the Gas Works Clauses Act 1847. The latter Act and its amendments also make provisions with regard to the formation of Reserve and Insurance Funds, and provide for the issue of new capital under what are known as the Auction Clauses. The appropriation of profits under the sliding scale is also introduced.

One of the most important matters, from the Auditor's point of view, is the division of all expenditure into two classes—Capital and Revenue. The wording of the statutory form of accounts will probably sufficiently indicate the basis of this division; it remains, therefore, to say that, perhaps, the Auditor's most important duty is to see that this basis is maintained. It is not, however, always possible for the Auditor to judge as to the correctness with which, say, the cost of an extension has been apportioned as between Capital and Revenue; nor, indeed, is it necessary that he should so constitute himself an engineering expert. He will, however, require to see that the company's engineer has certified the apportionment to be correct, and that the expenditure on Capital Account has been passed by the Board. In addition, it is desirable that he should satisfy himself that the principle followed by the engineer in arriving at his apportionment is a sound one. There is, properly speaking, no "safe side" in these matters—an undue charge to Capital is unfair to the proprietors, while an undue charge to Revenue is (through the operation of the sliding scale) an injustice to the consumers. The following examples of apportionment will, however, be found useful, as indicating, in general terms, the correct method of arriving at the amount chargeable against Capital, and against Revenue, in any special case that may arise:—

NEW WORKS (including extensions):—Capital.

NEW WORKS IN PLACE OF OLD WORKS: Charge original cost of old works pulled down, less value of old materials, against Revenue; charge the remainder against Capital. (This amounts to debiting Capital with total cost, debiting Revenue and crediting Capital with original cost of old works, and crediting Revenue with value of old materials sold.)

CONVERSIONS: In a similar case to the last, except that certain old materials, instead of being sold, are used for other purposes on the works, treat the particular department of Capital Expenditure as the purchaser of the old materials in question, debiting it with the value of the materials and the full cost of conversion (if any).

The income of a Gas Company consists of Gas Rates, Meter Rents, Residuals sold, and generally profit on Fittings and Rents, in addition to Transfer Fees and Interest on Investments. The collection of Gas Rates and Meter Rents are best checked in totals (in the manner shown under FIRE INSURANCE ACCOUNTS, care being taken to fully test both allowances and arrears), the total receivable being arrived at from the State of Meters Book, which will show the total amount of gas consumed and what meters are on hire. The residuals sold cannot well be checked as to quantity (save by comparing the results of various working statements), but, of course, the Auditor may, and should, check the collection of the amounts debited. The same remark applies to fittings, which will almost invariably be found to form a part of a Gas Company's business, although no mention of the circumstance will be found in the statutory form of accounts. It may be added that it is best merely to state the profit arising from fittings on the credit side of the Revenue Account (rather than to credit Revenue with Income, and to debit it with Expenses), as there is nothing gained by showing the whole world what percentage of profit has been made. The two leading items of expenditure arise from stores and wages; the latter has already been considered in Chapter I., and the former in Chapter II., and need no further consideration beyond saying that both must be fully vouched for, and carefully tested. All Cash Book entries must, of course, be vouched, and the additions checked and the balance verified; also, all the General Ledger postings should be called back.

Some companies charge all renewals and repairs against the Revenue of the year in which they are executed, but a more scientific method is to set aside a sufficient sum annually for renewals, and to charge their cost against the fund so created.

The investments held against Reserve, Insurance, and (if any) Depreciation Funds, must be verified by an inspection of the securities held.

This leads up to the consideration of the Depreciation Fund (in reality a Sinking Fund), which must be accumulated by

companies owning works on leasehold lands. The case will not often arise, but, when it does occur, a sufficient sum must be set aside, and invested to accumulate to the cost of the works by the time the lease expires. The Auditor will require to satisfy himself as to the sufficiency of the annual instalments.

It may be added that accounts have to be taken annually on the 31st December, and that a copy of the accounts must be filed with the prescribed local authority before the following 31st March.

Formerly, the Auditors of Gas Companies' accounts were required to be shareholders, but in several recent Special Acts this qualification has been removed.

Metropolitan Gas Companies are subject to an official audit by the Board of Trade, but this does not prevent them from securing the advantages of a professional audit in addition.

MUNICIPAL AUTHORITIES are frequently empowered to trade in gas, but the consideration of these accounts is best deferred until the question of CORPORATION ACCOUNTS is reached (*vide* Chapter IV., section VI.).

(b) WATER COMPANIES.—The mode of audit best adapted to the accounts of Water Companies is practically identical with that which has just been considered. Some of the Acts there specified do not, however, apply to the undertakings of Water Companies; and, in particular, there is no general statutory form of accounts. The Metropolis Water Act 1871 contains, however, some important provisions, which are included in Appendix "A."

It is a very general practice to assimilate the accounts of Water Companies, as near as may be, to the form laid down for Gas Companies in Schedule B. of the Gas Works Clauses Act 1871—indeed, it is difficult to conceive a form better adapted for this purpose.

The audit of Water Companies is slightly simpler than that of Gas undertakings, by reason of the fact that the rates charged are, for the most part, fixed, instead of fluctuating

with the quantity used. Such portion as is supplied by meter, for trade purposes, will entirely follow the method recorded under GAS COMPANIES. With regard to the greater portion, which is based at a sliding scale (for which see the Special Act) upon the rateable value of the houses, it is not usual to exhaustively check the calculations involved, but they should be *tested* to such extent as may appear desirable. Vacancies should be vouched for by a declaration of the owner that the property in question has been vacant for the whole of the quarter. Allowances (which should be very exceptional) must be properly explained, while arrears and bad debts must both receive careful attention.

Most companies are empowered to make their rates in advance, and consequently their books will, at the date of the accounts, reveal a profit that has not yet been earned: due allowance must, of course, be made for this in the General Balance Sheet.

GAS AND WATER COMPANIES (COMBINED) will—in almost every instance—be found to be required by their Special Acts to keep the accounts of the two undertakings entirely separate. In the few old companies where no such provision exists, separate accounts should, at least, be made out for Capital Expenditure and Revenue (the management expenses being apportioned according to, say, the ratio of the average gross income from each department), so that the profit upon each may be known and the proper working statistics prepared.

(c) ELECTRIC LIGHTING ACCOUNTS.—The statutes relating to Electric Lighting Accounts are the Electric Lighting Acts 1882 and 1888, together with the Board of Trade rules thereon. A concession (which, by the way, does not grant a monopoly) may be obtained either by a Special Act of Parliament, a Board of Trade Licence, or a Board of Trade Order, and may be granted to a private individual, a company (incorporated either under the Companies Acts, or by a Special Act), or to a Local Authority. There are no special provisions as to audit in the General Acts, it being left to the concessionaires to provide for audit as they may think best.

The Board of Trade have issued a special form of accounts: and accounts, drawn up in the prescribed form, are to be forwarded to the Board on or before the 31st March in each year, for the year ended the previous 31st December. The form now in use (which is shown in Appendix "A") is based upon that required from Gas Companies—the electricity being sold by the "unit," instead of by the thousand cubic feet.

The general method of audit will practically follow the lines indicated under the head of "Gas Accounts"; especial care should, however, be directed to the correct apportionment of expenditure between Capital and Revenue.

One caution in conclusion may not, however, be out of place: where no regular Bought Ledger exists—and this state of affairs will also be frequently found in connection with both Gas and Water Companies as well—particular care will be necessary to guard against any omission of outstanding liabilities, when the annual accounts are drawn up.

V. TRAFFIC ACCOUNTS.—(a) RAILWAYS.—In almost every instance Railway Companies are incorporated by Special Act of Parliament. Such companies are subject to the provisions of the Companies Clauses Act 1845, and the Railway Companies Act 1867, and the Regulation of Railways Act 1868 (extracts from which will be found in Appendix "A"), in addition, of course, to the requirements of their own Special Acts. A few foreign and colonial railways have, however, been registered under the Companies Acts: in such cases, of course, the details of administration will follow the provisions of the Act under which they are registered; but it will generally be found that the articles of association enable the accounts to be kept and audited in the same manner as those of companies registered under a Special Act of Parliament. Attention should be directed to any legislative requirements that may be operative in the country where the railway is situated.

The statutory form of the half-yearly accounts and the Auditor's certificate are to be found in Appendix "A"; it,

therefore, remains to consider what the extent of the Auditor's investigation should be which will enable him to certify that the accounts are a "full and true statement of the financial condition of the company, and that the dividends proposed to be declared on the stock and shares of the company are *bonâ fide* due thereon, after charging the revenue of the half-year with all expenses which, in (our) judgment, ought to be paid thereout."

The actual extent of the Auditor's responsibility is a matter of some little uncertainty, but it is at least certain that he is not to be held responsible for every detail of the half-year's recorded transactions. The audit of these details occupies the whole time of the Chief Accountant and the audit staff; and not only would it be a physical impossibility for the professional Auditor to go over the whole of their work, but it would also be a lamentable waste of time and money.

The Audit Office, in itself, constitutes a continuous and thorough check upon every other department under the supervision of the Accountant, and, as no moneys whatever pass through the office, it may safely be taken that the work is honestly performed.

The Auditor's work may thus be said to commence with the certified returns of traffic, and the certified accounts of tradesmen and others. He must, however, himself examine and verify the summaries of these items. He must see that they tally with the cash and bills received, and that the latter find their way into the bank in due course. He must examine the vouchers of all expenditure, and, so far as possible, verify its apportionment; in particular must he satisfy himself as to the correctness of the apportionment of such expenditure between Capital and Revenue. With regard to the issue of new capital, he must see that the amount actually received agrees with the totals shown in the Stock and Share Ledgers kept at the secretary's office. He should compare the certified returns of the Railway Clearing House and "Foreign" Railways with the entries in the books of his own company. He should check the transactions in bills in detail, follow the matured bills into

the Banking Account, and verify the outstanding Bills by the inspection of the actual documents. He must check the traffic outstandings with the certified statements, examine the entries on both sides of the Banking Account, and check the additions, and, so far as possible, the classification of the items. He should examine all debentures that have been redeemed, and see that they have been cancelled. He should vouch the payment of dividends and interest by the original warrants, produced from the secretary's office for that purpose, and scrutinise all outstanding amounts. He should examine the accounts for repairs done to the rolling stock of customers, and compare the lists with the Ledger. He should examine the accounts of rent received, thoroughly check the General Ledger, compare the balances of the various Stock Accounts with the certified list of stores on hand, compare the totals of the General Ledger Expenses Account with the totals of the subsidiary books. It will then still remain for him to ascertain that such liabilities as traffic drawbacks are provided for, verify the investments by inspection of securities and examination of the interest received, compare the capital issued with that authorised by Act of Parliament and shareholders' minutes, give a final consideration to the apportionment of Capital and Revenue Expenditure, and see that the necessary certificates have been furnished as to the efficiency of the permanent way, rolling stock, &c.

(b) SHIPPING COMPANIES.—Unlike the accounts of Railways, the accounts connected with marine traffic are subject to no special statutory provisions with regard to form.

There is no essential difficulty in connection with Shipping Accounts, but the fact that it is most desirable and customary to show the net result of every voyage of every ship necessitates some very nice apportionment of the items constituting Shore Expenses and Insurance.

The extent of an Auditor's investigations will vary greatly in different cases: in the case of a Single Ship it is desirable that the audit be as exhaustive as possible; but in the case of one of the larger Companies such a course would be quite as

impracticable as in the case of a Railway. The actual extent in any particular case will thus be very largely a matter of arrangement and of expediency.

The following considerations may, however, be safely submitted, as they will in every case require to be dealt with in more or less detail.

Ascertain that freights and passage money are duly accounted for; that the apportionment of shore expenses is equitable; that the Cost Accounts are not improperly manipulated (especial care being required where one Cost Account is kept for a whole fleet); that only structural improvements are debited to Cost Account; that proper depreciation is allowed—especially in regard to boilers; that outstanding freights and agents' balances are provided for in accordance with the documentary evidence; that unclaimed return passages are in order; that proper return of insurance premiums has been obtained for the time during which any vessel has been "laid up," and, generally, that insurance matters are in order; that the question of foreign exchanges has been dealt with upon a proper basis; and that no profits are taken credit for on account of uncompleted voyages.

In order to prevent misunderstanding, it seems desirable to point out, for the benefit of the reader who has no experience of Shipping Accounts, that the "Cost Account" is really neither more nor less than a Capital Expenditure Account, and must on no account be compared with the Cost Accounts kept by manufacturers.

Some shipowners, instead of insuring with underwriters against risk of total loss or damage to their vessels, raise an Insurance Fund wherewith to meet such losses by periodical charges against Revenue. The effect, of course, is that, instead of Profit and Loss being debited with insurance premiums, it is debited with an instalment—probably somewhat in excess of that which would have been thus paid—which is credited to the Insurance Fund. At the same time, to make the Insurance Fund really effective when required, it

is desirable that a corresponding amount of cash should be invested in readily realisable securities, the Insurance Fund thus becoming for all practical purposes a Sinking Fund, rather than a mere reserve. When any loss is incurred, the cost of replacing it is debited to the Insurance Fund Account, a corresponding amount of investments being realised to provide the necessary cash. It need hardly be pointed out that an Insurance Fund can only become an effective provision against loss in the case of companies owning a large fleet of vessels, so that within their own experience they get a reasonable average of risk. Even here, however, it will sometimes happen that a loss occurs which will more than swallow up the whole of the accumulated fund, and the question then arises whether it is reasonable to bring forward the *debit* balance of the Insurance Fund Account as an asset upon the Balance Sheet. If there is a reasonable probability that this debit balance can be extinguished out of future instalments within a reasonable time, there is probably no objection to this course of procedure; but, in any event, it seems desirable that it should appear as a special item in the Balance Sheet, so that no shareholder may be deceived as to the actual position of affairs; and, in addition, the Auditor would do no harm by drawing attention to the facts in his certificate.

SINGLE-SHIP COMPANIES almost invariably make no provision for depreciation: the Auditor need not waste his time upon any efforts to convince his clients of the imprudence of this course, but he should not forget to append the necessary qualification to his certificate. The Auditor of Single-Ship Companies must bear in mind that, as regards fraud, there is no such thing as "safety in numbers" here, for the accounts are usually all in one person's hands—let him, therefore, not omit to examine the Voyage Account Book in detail. In a recent case it transpired that the same manager had control of the funds of several Single-Ship Companies; and, by an ingenious process of "ringing the changes," was enabled for many years to conceal from the auditors the fact that there were serious deficiencies in his Cash Balance.

(c) TRAMWAYS.—With the exception of the few tramway undertakings that are governed by the legislation affecting railways, there is no prescribed form in which the accounts of Tramway Companies are to be presented; considerable variations will therefore be found in the mode adopted by different companies. It is possible, however, that if—as appears likely—any considerable number of undertakings fall into the hands of local authorities, public attention will be sufficiently directed to the subject to cause a uniform system to be prescribed for the use of all Tramways.

The accounts are usually prepared upon the “Double Account” system; permanent way, rolling-stock, and horses constituting the items of Capital Expenditure. With regard to the first two items, on account of the extreme difficulty of making any periodical estimate of their value, the method adopted is, perhaps, the most convenient one—the work being maintained in a state of perpetual efficiency rather than reduced by depreciation and increased by renewals. As regards “Horses,” however, the unpermanent nature of this item appears—in spite of the fact that such a course is unusual—to lend itself more readily to the “Single Account” method of treatment—namely, by writing off depreciated value and debiting the account with fresh purchases. The certificates of the responsible officials must always be obtained for the efficiency of the assets represented by the Capital Expenditure.

The traffic receipts must be carefully tested, and it is not unusual for the Auditor to consider it necessary for him to go over the whole of this work in detail, commencing with the tickets, guards' books, or way-bills (as the case may be), and tracing the receipts on to the traffic sheets and daily and monthly traffic books, and seeing that the whole amount received has been duly banked. Where the system employed does not provide a perfect internal check, it would seem to be very desirable for the Auditor to examine every detail, for it is here, especially, that a leakage is likely to occur. It may, perhaps, seem superfluous to suggest the propriety of seeing that receipts are accounted for upon every day of the year.

The only other source of revenue of any importance will be advertising ; but as this is almost invariably sub-let to a contractor, it needs no comment.

The expenditure—which should always be made by cheque, no payment out of traffic receipts being on any account permitted—must be carefully vouched ; while the analysis thereof must, so far as possible, be verified. In particular the apportionment between Capital and Revenue must be thoroughly scrutinised.

The Horses Account is one that might easily be manipulated, and must be particularly watched ; the number of horses shown on the account should, of course, agree with the number stated on the vet.'s certificate.

Tramway statistics for short periods will be of but little value to the Auditor as a general check upon the satisfactoriness of affairs ; but statistics of longer periods may prove most useful, if intelligently applied.

VI. ACCOUNTS OF LOCAL AUTHORITIES.—The accounts of local authorities, and their audit, are subject to the provisions of numerous statutes ; the principal Acts being the Municipal Corporations Act 1882 (for the accounts of the Borough Fund), the Public Health Act 1875 (for the accounts of sanitary authorities), the Local Government Act 1888 (for the accounts of county councils), and the Local Government Act 1894 (for the accounts of parish councils), in addition to such Special Acts as may have been obtained. In Appendix "A" will be found extracts from such portions of the General Acts as are of professional interest.

For some reason best known to the Legislature, there is no statutory form for the accounts of the Borough Fund, but a return of "Receipts and Expenditure" must be made annually to the Local Government Board. The term "Receipts and Expenditure" is, of course, in itself—from an accountant's point of view—entirely meaningless, and it is generally under-

stood that the account required by the Legislature is an Account of Receipts and Payments (or Cash Account). Every consideration of convenience, however, points to the desirability of all local authorities submitting their accounts in the form of an Income and Expenditure (or Revenue) Account, so that the actual financial result of each year may be clearly comprehended. The result is that many local authorities prepare and publish accounts, which do not have to be—and probably are not—submitted to the Local Government Board for their approval; but it is understood that in some cases the actual Revenue Account has been filed instead of the prescribed Cash Account, and that it has been accepted.

Accountants will sometimes find themselves in the position of elective Auditor, but, generally, their appointment will be held independently of, and in addition to, the elective audit and direct from the corporation. It would seem that the elective Auditor has no power to enquire into, or to question, the legality of any payment; but a professional Auditor would probably be subject to no such restriction. Some doubt has, however, been thrown upon this view by the Court of Appeal in the case of *Thomas v. Devonport Corporation*.

The accounts must be made up and audited half-yearly, and printed and published annually, within one month of the close of the financial year. Both on account of the shortness of the time thus allowed for audit, as also upon more general considerations, it is, however, both advantageous and usual for the professional audit to be a continuous one.

The Accounts of the Sanitary Authority are upon the form settled by the Local Government Board. Where the authority is not also the council of the borough, the audit devolves upon the district Auditor, who is an official nominated by the Local Government Board; but where the sanitary authority is also a borough council, the accounts are Audited by the Auditors of the borough fund.

It is the opinion of most experienced Auditors that no efficient audit can be made without an exhaustive examination

into every detail, for the transactions of local authorities are so numerous and various that it is impossible to take a bird's-eye view of the matter. Thus the late Mr. WM. EDMONDS, F.C.A., F.S.S., in a lecture upon "Corporation Accounts," has said, "In my experience it is the smaller items of receipts and payments that generally are the most fruitful source for defalcations and irregularities. Non-professional Auditors would pass over much detail, and are frequently content to merely cast the Cash Account submitted by the Treasurer, considering such to be their sole duty." (*See also a few paragraphs further on.*)

The sinking fund instalments must in all cases receive the Auditor's close attention: he must satisfy himself as to their sufficiency for the redemption of the loans within the periods prescribed; and verify the investments of the fund, both as to principal and interest.

The actual significance of a sinking fund and the method of dealing with it in the books of a corporation are not always so well understood as might reasonably have been expected. As, however, the principle is exactly the same as that described with reference to insurance funds (under the head of Shipping Accounts), the matter need not engage further attention at the present time.

With regard to the routine to be adopted in any particular case, much will naturally depend upon the individual circumstances; but the best plan will be to reproduce here the "Instructions" prepared by the late Mr. F. R. GODDARD, F.C.A., for the audit of the Newcastle-on-Tyne Corporation Accounts. The standard here set up is, doubtless, a very high one, but it cannot be considered to involve anything beyond the strictest necessities. The late Mr. WM. EDMONDS, when speaking of these *pro formâ* instructions, said "In my opinion there is nothing superfluous contained in the lengthy detail set forth by Mr. GODDARD: for myself, I have found it absolutely necessary to check every penny of receipts and payments before I sign the accounts."

INSTRUCTIONS FOR AUDIT.

As revised at 10th March 1887.

MONTHLY AUDIT.

TREASURY DEPARTMENT.

Cash Receipts Pass Books.—Check additions of all Pass Books, and see that total receipts are signed for by Treasurer, and entered in Treasurer's or General Cash Books. See that the head of each Department signs the Pass Book of his Department weekly.

<i>Departmental Pass Books—</i>	<i>No. of Books.</i>
Package Dues	1
Cranage Dues	
Port and Harbour	
New Streets Formation	1
Materials Sold	
Manure Sold	
Work Done.. .. .	
Old Materials	1
Fever Hospital	
Rents	1
Rates	1

Collectors' Pass Books and Cash Books.—Check Debits of Pass Books with Collectors' Cash Books. See that the Collectors' Pass and Cash Books are initialled by Treasury Clerks. Check counterfoils, Collectors' Receipt Books, with their Cash Books, for two or three weeks in each half-year. See that Collectors sign their Pass Books and Cash Books weekly:—

Cattle Market (4), Cattle Market (Accommodation Pens, Corn Market), Concert Hall, Cattle Sanatorium, Concerts, Hirings, Thorough Toll, Butcher Market and Vegetable Market, High Bridge Female Lavatory, Elswick Park (3), Armstrong Park (3), Brandling Park (3), Leazes Park (3), Sandhill Weigh House, Refunded Workmen's Wages.

Miscellaneous Pass Books.—See that Pass Books are initialled by Treasurers' Clerks. Check occasional Counterfoils with Pass Books.

Baths and Wash-houses.—Check Daily Statements to Pass Book, and see that former are signed by Cashier and Superintendent.

Weights and Measures.—Check occasional Counterfoils with Inspector's Cash Book.

St. Mary's School.—Check a few entries in register occasionally.

Hay Market Weighage and Standage.—Check occasional Counterfoils.

Chimney Sweep Certificates.—Check Counterfoil Receipt Book.

Pedlars' Certificates.—Check Counterfoil Receipt Book, Cabmen's Badges, Science and Art Class (Public Library).

Public Library.—Check Vouchers at Library occasionally with Librarian's Cash Book.

Royal Grammar School.—Check Counterfoils for pupils' fees to Cash Book.

Town Hall Rentals (Meetings, &c.).—Check Counterfoils and Diary occasionally.

Organ Performances— do

City Concerts— do.

Freemen's Admission Fees.—Check Fees received with Freemen's Admission Book in Town Clerk's Office, Moor Small-Pox Hospital (Dripping Sold), Leazes Park (Skating), Recreation Ground (Skating).

Lough and Noble Models (Elswick Park).—Stick and Umbrella Receipts: check occasional Counterfoils, Gas Meter Book.

Treasury Receipt Books.—Check all Counterfoil Receipts given by Treasurer to Treasurer's Cash Book. Check all Day Book entries with Council Minutes, Police Pay Bills, Cattle Inspector's Sheets, and all other sources of information, and see that the correct amounts are carried into the books. Cattle Sanatorium (Standages).

Thorough Toll Compositions.—North-Eastern and North British Railways.

Fire Brigade Expenses.—Proportion charged to Insurance Companies: Call Fire Bills to Fire Brigade Day Book.

Services of Police at Factories.—Check vouchers to accounts and check additions of latter.

Town Hall Concert Room.—Letting of Hall, Organ, &c.

Hospitals.—Funeral 'allowances Repaid.

Criminal Prosecutions.—Magistrates' Clerk's Fees, Police Superannuation Fund (as per Police Pay Bills), New Road Baths (Rent from Lessee), Gallowgate Baths (Rent from Lessee), Northumberland Baths (Rent from Lessee), Home for Incurables (Garden Rent),

Explosive Licences (issued by Town Improvement Committee), Free-men's Admission (fees to Treasurer), Cemetery Company (Dividends on Shares), Scotswood Bridge Company (Dividends on Shares), Old Horses sold, Quay Shed Rents (List from Quaymaster weekly, not included in General Rents), Tramways (Lessees' Rent), R. Thompson's Bequest Fund (Loans Repaid), Sir T. White's Bequest Fund (Loans Repaid), Education Rate (Precepts on Overseers), Gaol Rate (Precepts on Overseers), Town Moor Intakes (collected for Free-men), Slaughter Houses Licences, Deposit Tickets (Rubbish), Virgin Mary Hospital (contribution to Grammar and St. Mary's Schools), Library Rate by (Precept on Overseers), Lunatic Asylum (Mr. Pace, Treasurer, separate Cash Book).

Miscellaneous Receipts (Interest, &c).—See that all Dividends and Interest on Funds invested for the year are received and entered in Cash Book.

Police Superannuation Fund, Dale Scholarship, Meikle Scholarship.—Interest Forms, Transfers by Cheque. Interest on Coal Dues. Money, &c. Receipts given on Receipt Forms, Transfers by Cheque.

H.M. Treasury.—Police Claims, Criminal Prosecutions, use of Police Van. Receipts on Special Forms supplied by Government.

Magdalene Hospital.—Dividends on Consols per Bankers.

School Grants.—Per Bankers on Government Forms.

Property Sold and Enfranchised.—Per Order of Council and by Deed enrolled.

Town Moor Purchase Account and Tyne Bridge Trust Fund.—Dividends on Consols.

Corporation 3½% Stock.—Check Stock Bank Book with General Cash Books.

CASH PAYMENTS.

Voucher Guard Book.—Call Vouchers and Wages Sheets to General Cash Books, stamping each voucher, and taking out list of missing vouchers in the Note Book. Bonds paid off and Conveyances of Property purchased to be produced as Vouchers. See that all Bonds paid off are properly discharged. See that Wages Sheets are signed by City Engineer and Surveyor.

Watching—Police Pay Bills.—Call Pay Sheets to Cash, checking separate Pay Sheets to total sheets.

Bank Pass Book.—Call Bank Pass Book to General Cash Books and check last Reconciliation, showing cheques outstanding and in hands

of Treasurer at date, checking those in hands of Treasurer with Counterfoil Cheque Books.

Treasurer's Petty Cash Book.—Check additions, and see that there is £150 in hand. Count Cash in hand half-yearly, after giving credit for sums paid after last meeting of Committee.

Treasurer's Cash Book.—Check credits to debit of General Cash Books. Check additions.

General Cash Books (3).—Check additions.

Reconciliation of Payments with Committee Minutes.—Check total payments in Cash Books to monthly Reconciliation. Check Finance and all other Committee Minute Books to Book containing record of all cheques drawn, and see that the total payments in the Cash Book agree with total amount of cheques drawn during the month, excepting cheques in the hands of Treasurer, which have not been entered in Cash Book nor paid away at that date, which must be produced to the Auditors.

DEPARTMENTAL MONTHLY AUDIT.

TOWN IMPROVEMENT DEPARTMENT.

New Streets Formation.—Cash Book. Check all Counterfoils of Receipt Books for Cash received at the Office, and also all Counterfoils of Collector's Receipt Books to Cash Books. Check Receipts in Cash Book to Treasurer's Pass Book.

Rate Department.—Check a few entries here and there in Collector's Cash Books to Treasurer's Pass Book. See that Clerk from Treasury Office initials the Collector's Cash Books as having been checked by him.

General Rents Cash Book.—Check additions of Cash Book.

St. Mary Magdalene Cash Book.—Check additions of Cash Book.

Package Dues Department.—Check all Counterfoil Receipts from Merchants and Wharfingers (2 Books) with Cash Book. Verify any exceptional allowances with documents relating thereto. Call Counterfoil Receipts for commissions to Wharfingers' Book and check additions. Call Cash to Pass Book and check additions.

Port and Harbour Dues.—Call Counterfoils, Quaymaster's Receipt Book to Cash Book, Cash Book to Pass Book, and check additions.

Cranage Dues.—Check Counterfoils to Pass Book, thence to Cash Book, and check additions.

HALF-YEARLY AUDIT.

TOWN IMPROVEMENT DEPARTMENT.

New Streets Formation.—Cash. Call all work charged during the period under audit from the Minutes and Estimates to the Day Book. Call Cash Book, Day Book, and Allowances Book to Ledger. Check additions of all books and extraction of balances half-yearly, proving their accuracy by totals. Examine arrears and take particulars of different classes of same yearly.

Old Materials Sold.—Check Book in Surveyor's Office with Invoices. Call Day Book and Cash Book to Ledger and check all additions. Check and prove balances and note arrears.

Manure.—Check yard sheets with Day Book in Surveyor's Office, one here and there as a test. See that all allowances are duly authorised by Committee. Call Day Book, Cash Book, and Allowance Book to Ledger. Check all additions and extraction of balances and prove same by totals in Reconciliation. Note arrears yearly.

Work done and Materials Sold.—Check occasional entries in Time and Materials Sheets to test correctness of Day Book entries. Call Day Book, Cash Book, and Allowance Book to Ledger. Check all additions, prove balances and note arrears.

Fever Hospital.—Check Register with Admission and Discharge Books. Call Register to Day Book, Day Book and Cash Book to Ledger. Prove balances and check all additions.

Rate Department.—Check rates made with Council Minutes, and see that Rate Books are signed by the Mayor and Town Clerk with Corporation Seal affixed. Call Counterfoil Receipts, which have not been used, to Irrecoverable Arrears Column in the Rate Books, and note any arrears written off for which no cancelled receipt is produced. Check additions (1 in every 3 pages). Check summaries, and see that the total cash received has been paid over to the Treasurer. Check General Summary in All Saints' Book, and also half-yearly Statement prepared by Mr. Pybus.

RENTS DEPARTMENT.

Rent Rolls.—Check occasional counterfoils for General Rents, and examine a few Tenants' Rent Books and Collectors' Collecting Books for Tenement and Market Rent by way of test each half-year. Check one week's receipts each half-year, and see that the total rents received agree with the total cash paid over to Treasurer during that week. Check Council Minute Book, Engineer's Tenancy Book,

Seal Book, Assignment Book, and Treasury Minute Book to Rent Minute Book and Day Book, to ascertain any alteration for General and Magdalene Rents. Call all entries in Rents Minute Book and Day Book to Rent Rolls as follows:—General Rent Roll, Magdalene Rent Roll, Tenement Rent Roll, Willington Tenement Rent Roll, Butcher Market Rent Roll. Check New Rent Rolls each year with that of previous year, and see that all alterations to close of preceding year are made in new Rent Roll. Check additions and Reconciliation in General Rent Roll. Check additions of all Rent Rolls, prove Summaries, and check same to General Rent Roll Reconciliation.

General Rents Cash Book.—Check receipts to Tenant's Pass Book. Check additions of Cash Book. Check Summary of Cash to Reconciliation in General Ledger and Enfranchisement Sales Ledger.

General Rents Ledger and Liberties Ledger.—Check half-year's rents charged to tenants, and see that all differences agree with Minute Books and Day Books. Check the following Books with Ledgers:—Empties Book, Rates and Taxes Book, Arrears Book, Balance Book (yearly), Check additions of these books and totals to Reconciliation at end of General Ledger.

St. Mary Magdalene Cash Book.—Check receipts to Pass Book, and check Summary to Reconciliations in General Ledger and Enfranchisement Sales Ledger.

St. Mary Magdalene Rent Ledger.—Check half-year's rents charged to tenants, and see that all differences agree with Minute Books and Day Books. Check the following Books with Ledgers:—Empties Book, Rates and Taxes Book, Arrears Book, Balance Book (yearly). Check additions of these Books and totals to reconciliation at end of General Ledger.

Enfranchisement and Sales Ledger.—Check interest for half-year, and check balances, arrears, rates and taxes, and carry to Reconciliation at end of Ledger.

Paving and Flagging Ledger.—Check half-year's charge and check balances.

PACKAGE DUES DEPARTMENT.

Check Register of Vessels arriving and sailing to Declarations of Cargo. Call Declarations of Cargo (see that Manifests are signed) to Manifest Summary, and check Manifest Summary additions. Call Cash Book, Allowance Book, and Commission Book to Ledger and check additions. Call Ledger to Balance Book, check additions of latter, and prove total amount of balance by totals of the various books, as shown in the Reconciliation Statement; make copy of

Reconciliation. Check transfers from Mr. Pace's Cash Book to Mr. Harvey's Petty Cash Book, and check additions of Petty Cash Book. Check transfers from Petty Cash Book to Stamp Book, and check additions of Stamp Book.

PORT AND HARBOUR DUES.

(Rent of Goods impounded by Quaymaster.)

Call Cash Book and Day Book to Ledger. Check additions of Ledger and check Balances to Balance Book. Check the Quaymaster's record of Goods impounded daily with the Day Book.

CRANAGE DUES.

Check sheets certified by Mr. Laws to Day Book. Call Day Book to Journal, Journal to Ledger, Cash to Ledger, Call Allowance Book to Ledger, and check additions of all Books. Call Ledger balances to Balance Book. Check Balance Book additions.

TOWN CLERK'S OFFICE.

Check Vouchers and all Deeds, &c., for Stamps charged into Cash Book, and make a note of any missing. Check from Counterfoil Receipt Book and Bills of Cost Book to debit of Cash. Check Sales of Parliamentary and Municipal Registers with Counterfoils, Fees on Leases for 75 years with Seal Book, Fees for Bonds under Thompson and White's Bequests with Loans granted, Fees for Freeman's Certificates of Birth with Guild Book, Fees for affixing Mayor's Seal to Affidavits and Foreign Documents with Register of same, and Fees for Freeman's Admissions to Freeman's Admission Minute Book. See that total receipts and payments agree with transfers in general Books.

MAGISTRATES' CLERK'S OFFICE.

(This Audit to be done on Wednesdays). Check Rough Cash Book to Cash Book of Apportionment, and check latter to Daily Summary Book and latter to Monthly Summary Book signed by the clerk. Check Vouchers of payments to Treasurer, and see that same agree with Magistrates' Clerks' Monthly total. Check additions of all Cash Books.

COUNCIL MINUTES.

Finance Committee Minutes.—Read through Council Minutes, checking into Seal Book all Bonds, Mortgages, Assignments, &c., and taking notes of all Cash transactions passed by the Council, and extract all Minutes relating to Special Grants and payments, increase

in Salaries, &c., from Council and Finance Committee Minutes; also Town Improvement, Watch, Sanitary, Town Moor Management, Schools and Charities, Public Libraries, and Parks Committee Minutes. See that Council and Committee Minute Books are signed by Mayor and Chairman of Committees respectively.

Seal Book.—Check with and from Council Minute Book all entries in Seal Book, Call to General Rents and Magdalene Hospital Rents Day Book all new Leases, Assignments, &c., also to Bond Book and Stock Registers, New Loans to the Corporation, ticking the latter to the left of the amount.

STOCK REGISTERS.

Redeemable, Irredeemable, Holder, Bearer.—Check money paid from Cash Book, ticking to the right of the amount. Check Duplicate Stock Certificates issued to Stock Registers. Check Transfer Deeds to Transfer Registers and call latter to Stock Registers, and check total of Ledger balances to Summary. Check all Certificates issued to Council Minutes and Seal Book. Check balances of Stock Ledger to List of Stockholders, and see that total agrees with Summaries of Stock Registers at 25th March (yearly).

Bond Book.—Check with Cash Book the Cash received for new Loans, ticking to the right of the amount. Check Loan repayments into Cash Book and compare same with yearly Ledger, and see that the correct balance is brought down and carried forward each year.

LEDGERS.

Capital and Special, General Rate, City Fund, Intermediate and Trust Accounts.—Call Cash and Transfer Journal Posting and check additions. Check balances at 29th September and 25th March.

Treasury and Bequest Ledger.—Call postings of Treasury Cash Book, Miscellaneous Day Book, Sanatorium Day Book, Allowances and Fire Brigade Day Books to Treasury, and Bequest Ledgers (Thompson and White). Check all additions and extraction of balances. Check Summary of Cash Receipts and Payments and Cash Balances at 29th September and 25th March.

Outstanding Accounts and Allowances in Treasurer's and New Streets Departments.—Check half-yearly Statement of Accounts and Arrear Book (2).

Note.—Chief Clerk to examine all Pass Books and Collectors' Cash Books at the close of half-year, and see that they have been checked and initialled by Treasury Clerks, and that the Audit Instructions have been properly carried out in each case. Chief Clerk to initial each Pass Book and Cash Book, with date when examined by him.

YEARLY.

St. Mary Magdalene Hospital, Cash Book.—Check additions and see that total agrees with Balance Account in Ledger.

Package Dues, Cash Book.—As above.

Public Libraries, Ledger and Cash Book.—As above.

Lunatic Asylum.—Check balance forward from previous year. Check amount receivable for the year current from the Precepts and Minute Book. Check amount received from the Counterfoil Receipt Book. Check Bank Account, vouch all payments. Check balance forward and all additions.

Securities for Invested Funds.—Check Securities in hands of Town Clerk and Treasurer.

Accountant's Department.—Check Statement of Assets and Liabilities with Ledger. Check Redemption of Stock, Borrowed Money, Borrowing Powers.

Since the first edition of this work appeared, the attention of the profession has been very prominently directed to the great diversity of the forms in which the accounts of corporations are stated. Many of the variations to be found are mere differences of detail that need not be considered here; but, on the other hand, many corporations adopt a form that seems to be quite opposed to all principle, and such forms are, of course, to be resisted.

It is thought that the published accounts of every corporation should show (*inter alia*) an Account of Income and Expenditure and a Balance Sheet for each separate department or fund, and also an Aggregate Balance Sheet. The desirability of following this course is not likely to be questioned—it

remains only to discuss the form that the Balance Sheet should take. The forms at present in use are most diverse, but they may (disregarding details) be said to be all based upon one or other of the following principles :—

(1) All classes of capital expenditure are treated as assets, and

(a) Perpetually maintained at cost.

(b) Written off as the loans are repaid.

(c) Written off as the value becomes reduced by effluxion of time.

(d) Re-valued periodically, and the difference charged to revenue.

(2) Only Realisable Assets are included in the Balance Sheet as assets, the subsequent treatment being as before.

(3) Only Revenue-bearing Assets are included in the Balance Sheet as assets, the subsequent treatment being as before.

It is strongly contended that (1) is the only true principle, and that the subsequent treatment should be upon the lines of either (a) or (c): both (b) and (d) are regarded as unscientific in method and false in principle. With regard to the choice between (a) and (c), the balance of advantage appears to be in favour of the former; that is to say, it is considered that the double-account system is more suitable to this class of accounts than the single-account system. It is, however, clearly desirable that *obsolete* or *non-existent* assets should always be written out of the account, and attention should be directed to this point at every audit.

The more recent volumes of *The Accountant* contain much that is of interest and value in relation to Municipal Accounts, and it will be found that the view there advocated is the one now recommended by the present writer. The position is shortly, but fairly completely, set out in an article that appeared in that journal on the 23rd March 1895. This article concludes as follows :—

There can, we think, be but little doubt that the accounts of all local authorities (which, for convenience sake, we describe under the term "Municipal Accounts") should be so framed as to contain the fullest information possible in the most intelligible form. This being granted, it further follows that not only is it desirable that the outstanding indebtedness of the municipality should be clearly shown, together with the amount of loans redeemed, but, further, that the accounts should show, with equal clearness, the exact manner in which the whole of such loans have been expended, and the residual value which may fairly be said to remain as an asset. We do not, of course, suggest that every kind of expenditure for which a Corporation may be permitted to borrow is, of necessity, in the nature of an asset, but it is at least in the nature of capital expenditure, and should, we think, be so treated in the accounts; and our own view is that the General Accounts should not be complicated by any question of depreciation, except in relation to works that are not of a permanent character—or in relation to works which, while treated as capital expenditure, in the sense that a Corporation is permitted to borrow upon them, are really in the nature of revenue expenditure extended over a term of years equal to the time given for the repayment of the loan. With these exceptions we think that the total expenditure should be brought forward from year to year in exactly the same manner as it would be in the case of a railway or any other undertaking upon the double-account system, the consequent effect of which would be that all loans extinguished (less "temporary" capital expenditure written off) would appear upon the General Balance Sheet as a surplus. Perhaps some more appropriate name than "surplus" might have to be found for this balance, but we think that the items of which we suggest that it should be composed are the most appropriate items to appear as the difference between the two sides of the General Balance Sheet. Supplemental Capital Expenditure Accounts might, and indeed should, we think, be added, marshalling the various items of capital expenditure, first into the headings of the various departments, and secondly under some such headings as those advocated by Mr. GUTHRIE. These might conveniently be set forth in tabular form, as giving, perhaps, the maximum of information and clearness combined.

The question as to whether or not depreciation should be provided for is one which has already been discussed, but upon which more might yet be profitably said. We are not sure that a sufficient case has been made out to establish the necessity for a different treatment from that which obtains in the case of railway companies. Doubtless, like railway companies, municipalities would often require to create some reserve, even if it did not appear in their accounts expressly

as depreciation; but, from whatever point of view the matter is regarded, there can, we think, be nothing more illogical than the method adopted by some Corporations of depreciating their assets at such a rate that, when the loans out of which such assets were created are redeemed, these assets will have been written down to zero in the accounts. In the case of the older loans and stocks, where a very long period for redemption was permitted, there might very easily be some sort of connection between the rate of redemption and the rate of depreciation; but loans now authorised have frequently to be repaid in such periods that it is obviously the intention of the Local Government Board and the Legislature to arrange matters so that the whole loan shall be redeemed some considerable time before the asset has ceased to possess a value. Consequently, to adhere in the accounts to a rate of depreciation which is equal to the rate of redemption required for the indebtedness, is to adhere to a system which not only fails to exhibit the actual facts of the case, but also fails to express what was obviously the intention of the authorities authorising the issue of the loans.

MUNICIPAL GAS, WATER, AND ELECTRIC LIGHT WORKS.—These accounts must not be dismissed without at least a few words of notice. The Act or Order authorising the particular undertaking must, of course, be carefully perused, but a few general considerations obtain.

So far as applicable, the method of audit described under these respective headings (*ante*) will be found useful in connection with the audit of municipal undertakings; but it is well to note, in passing, that corporations are not bound to adopt the form of Gas Accounts set out in Schedule B. of the Act of 1871. It would appear, however, that—for the present, at least—the form of Electric Light Accounts prescribed by the Board of Trade is applicable to such undertakings as may be in the hands of local authorities.

The question has been raised (and, it might be added, discussed *ad nauseam*) as to whether local authorities should or should not set aside a sum for depreciation in addition to sinking fund instalments. It has been ingeniously contended that the sinking fund instalment is required to be set aside “out of profits,” or (if there be no profits) out of the rates, and that no profits can exist until depreciation has been provided

for. Few terms are more elastic than the term "profit," but it may be remarked that the profits divisible among the shareholders of a gas company are—according to the statutory form of accounts—*not* arrived at *after* an allowance for depreciation has been deducted. It would appear that the *modus operandi* here sanctioned (*viz.*, to maintain the efficiency of the works out of revenue, but to keep the Capital Expenditure Account intact) is equally applicable to the accounts of similar undertakings in the hands of local authorities.

In dealing with the audit of these accounts, however, care must be taken to inquire into the sufficiency of the sinking fund instalments and into their due investment.

The accounts of COUNTY COUNCILS, RURAL SANITARY AUTHORITIES, HIGHWAY BOARDS, ASYLUMS BOARDS, VESTRIES, &c., present no special feature that needs explanation.

VII. EXECUTORS' AND TRUSTEES' ACCOUNTS.

—It will sometimes happen that the professional accountant is called upon to audit the accounts of executors or trustees, on behalf of some dissatisfied beneficiary.

The purport of the Auditor's investigation in such cases will be to ascertain that the terms of the will or trust have been complied with, and that no improper use, or unauthorised investment, of the trust funds has occurred. Questions of apportionment between Capital and Income will also claim his attention.

The fullest investigation into details will be necessary, except perhaps where the trustees have been authorised to carry on the testator's business, and there is no suggestion that their conduct has, in this respect, been improper.

In addition to the will and probate, and the accounts kept by the executors and trustees, the Probate Account (with any subsequent corrective accounts)—or its more modern equivalent—and Residuary Account, together with the Minute Book (if one be kept) and all documents and vouchers, will require to be carefully examined.

With regard to the question of apportionment, it is important to remember that all interest accrued to the date of death forms part of the *corpus*; that the profit or loss arising from any subsequent *bonâ fide* change of investment falls, as regards capital, upon capital, and as regards income, upon income; that, even where investments of a wasting nature are specially authorised, the whole of the income does not of necessity pass to the life-tenant—the usual custom being to consider four per cent. as income, and to capitalise the remainder (*vide Nicholson's case*, Ch. 1895); that any loss arising out of an unauthorised investment falls upon the trustees personally, who are liable to repay the amount with such interest as the Court may direct—the rate being usually four per cent. (simple interest), except where the trustees have applied the funds to their own use, when a higher rate is generally charged. Any of the above provisions, may, however, be modified by the special terms of the will or other instrument creating the trust.

It is also important to remember that beneficiaries, unless of full age, have no power to consent to any variation in the terms of the trust.

It may sometimes occur (in fact, it has occurred) that a trustee, carrying on the business of his testator, has depreciated the goodwill by attracting the customers to his own (similar) business. It would, however, be very difficult to establish a liability against the trustee in such a case, except upon the face of the most convincing evidence.

In conclusion, it need hardly be pointed out that one of the most important duties in these audits consists of a very careful verification of the investments.

CHAPTER V.

SPECIAL CONSIDERATIONS IN DIFFERENT CLASSES OF AUDITS.

(*Continued.*)

VIII. ACCOUNTS OF INSTITUTIONS.—(a) CHARITIES.—Under this head may be considered the accounts of Hospitals, certain endowed Schools and Almshouses, and similar institutions.

In the early part of 1890 a Committee of the Charity Organisation Society appointed a sub-committee, consisting of four well-known Chartered Accountants, to enquire into the best methods of preparing and auditing the accounts of Charitable Institutions.

This sub-committee devised *pro formâ* accounts, which were recommended for the use of various types of charitable institutions, and copies of these forms are reproduced in Appendix "B." For institutions without property, or trading, or indebtedness at the close of the period, a simple Account of Receipts and Payments is prescribed; for institutions having property, but not carrying on trading operations, a Balance Sheet and an Account of Receipts and Payments are recommended; or, if there be current liabilities at the close of the period, an Income and Expenditure Account. While, in the case of institutions carrying on trading or manufacturing operations, a Trading Account is prescribed in addition.

With regard to Endowed Charities, certain statutory provisions obtain; but inasmuch as they do not practically affect the Auditor's position it has not been thought necessary to include them in the Appendix.

The distinguishing feature of most charities' accounts is the receipt of subscriptions and donations. These will, of course, require to be vouched in the usual way; but, perhaps, the most effective check consists in the publication of a list of subscribers and donors along with the accounts.

Another important point is that charities are not liable for income-tax; it should, therefore, be seen that none has been paid, and that the tax deducted from dividends received upon investments has been refunded.

The following extracts from the "Instructions for the guidance of Secretaries," prepared by the before-mentioned sub-committee, will form an appropriate conclusion to this section:—

" 1.—Where Form I. [a simple Receipts and Payments Account] is used, the Cash Book should be kept upon a columnar method, so that the analysis appearing in the Treasurer's Cash Statement may be easily followed by the Auditors.

" 2.—Where a Banking Account is kept, all cash balances should be paid into the Bank on the last day of the period to be reviewed.

" 3.—A list of all books kept by the Institution should be handed to the Auditors, all the books being open to inspection.

" 4.—In Forms II. and III. (involving an Income and Expenditure Account) the accounts should be kept in Ledger, opening in the form in which they will be presented in various financial statements.

" 5.—(Immaterial.)

" 6.—The Books should be balanced and the Statements for audit prepared prior to the visit of the Auditors.

" 7.—All Deeds and other Securities should be kept in a Deed Box at the Institution's Bankers, the box having three locks, the keys of which should be held respectively by the Treasurer, Secretary, and another member of the governing body.

" 8.—(Immaterial.)

" 9.—Before going to press the printer's proof of the Subscription Lists and Accounts should be examined by the Auditors.

" 10.—(Immaterial.)

" 11.—All vouchers of payment should be arranged in the order of the dates of payment prior to the audit.

" 12.—All Bankers' Pass Books, made up to the end of the period under review, should be at hand at the time of audit."

Many of these points do not relate solely to Charities' Accounts, but will be found useful at all times; they are, however, mentioned in this connection because they appear to indicate the lines upon which the audit should run.

(b) CHURCHES.—In many respects the audit of Church Accounts is a peculiarly thankless task. Apart from the fact that they are hardly ever submitted to the Auditor in anything approaching proper form, it is almost invariably the case that no effective internal supervision is exercised, and frequently large sums will pass through, say, a verger's hands without any proper check being kept upon his dealings.

The Auditor must check everything he can, and try to teach his clients the elements of commercial caution; but it is probable that he will never feel *quite* happy with a church audit. The writer well remembers, upon one occasion, being refused permission to count a balance of over £100 (practically a running balance) that was in the hands of the verger: not long afterwards—but, nevertheless, after repeated warnings—the suspicions of the vicar were at length aroused, and the verger was instructed to pay his balance into the bank. It seems unnecessary to add that he was unable to do so.

CHURCH SCHOOLS receiving a Government grant are required to keep an account of all receipts and payments in the prescribed (columnar) form. Such account is made up annually on the 31st May, and summarised upon a statement which for some occult reason is called the Balance Sheet. This statement (of which a duplicate copy must be furnished) has to be signed by the Treasurer and the Auditor, and—together with the Cash Book and all vouchers—submitted to the Government Inspector upon the date appointed for his visit. It is not necessary to produce vouchers for subscriptions received, nor yet for small payments; but it is important to remember that, if the accounts are not in order, payment of the grant of the Education Department will be delayed.

Since the 30th September 1891 the abolition of "School-pence" has simplified the accounts of most Church Schools.

Since June 1898 the Education Department has required that the accounts of the receipts and expenditure of every school receiving a share of the aid grant shall be annually audited by a Chartered Accountant, an Incorporated Accountant or—in cases where no one so qualified is available—by some other person (not being a manager or treasurer of the school), whose competency is proved to the satisfaction of the Department.

(c) COLLEGES AND SCHOOLS.—These accounts call for but little comment. The usual method of audit may be said to consist of a "cross" between that employed in "Charities" and "Hotels" (*q.v.*), but it may be added that only a detailed audit is likely to be found entirely satisfactory.

Many UNIVERSITY COLLEGES are subject to the Statutes made by the Commissioners appointed under the Universities Act 1877, under which duly audited accounts have to be submitted to the University. In most cases a tax is payable upon the amount of income received.

ENDOWED SCHOOLS are nominally under the control of the Charity Commissioners, to whom copies of the Annual Accounts

should be forwarded. The principal point to be remembered is that the Governors have no power to apply the *corpus* of the endowment to current purposes.

IX. BUILDING AND FRIENDLY SOCIETIES, ETC.

--(a) BUILDING SOCIETIES.—The enormous number of frauds—some of them of disastrous proportions—that have occurred in the accounts of Building Societies within the last few years should suffice to make the Auditor of these accounts more than usually cautious.

The Building Societies Act 1874 left the appointment of the Auditors to be dealt with by each society in its rules, but it was generally considered that at least two Auditors must be appointed, the usual custom being for the directors to appoint one Auditor, and the shareholders the other. In many cases, however, Chartered Accountants were not appointed, and it is probable that most of the disasters are attributable to this circumstance. This condition of affairs has been partially remedied by the Building Societies Act 1894, which requires that at least one of the Auditors shall publicly carry on business as an accountant. In the majority of cases the Auditors so appointed have been Chartered Accountants, but it will be seen that this is still not required by the statute; moreover the wording of the section is so vague that cases still exist of accounts not being audited by *bonâ fide* public accountants at all. It is well, however, not to lay too much stress upon the evils attending the appointment of a wholly unqualified man as Auditor, for the danger does not by any means stop here. It will usually be found that the whole management of a building society virtually devolves upon one man, who—besides having both books and cash under his entire control—turns the whole of the board round his little finger. Add to this the fact that many building societies are virtually banks (and this fact has not been materially altered by the recent Act), and that the system of bookkeeping employed is generally of the most primitive kind, and some idea of the responsibility of the Auditor's position may be gained. The complexion of affairs is hardly improved where there is more than one real worker

upon the staff: any system of efficient internal check is all but unknown (except in a few—a very few—of the best and largest societies), while the class of man employed is usually very different, and very inferior, to the class of man employed in banks for work of a very similar nature.

The great majority of frauds that have been committed have remained undetected by reason of the very superficial examination bestowed upon the accounts by the Auditors; but cases have occurred in which the most detailed audit (conducted by unskilled men truly, but none the less detailed on that account) has failed to detect anything wrong.

The author's experience of Building Society Accounts—and these remarks apply equally to every class of accounts included under this heading—has convinced him of the extreme importance of checking every addition, posting, and voucher, of carefully verifying every amount received in redemption of mortgages or paid out to investing shareholders; of comparing *every* Pass Book with the Ledgers, and both with the lists of balances; and of testing the latter at considerable length in respect of the calculation of interest. The income received from properties on hand must be verified in every possible way; and, where such income does not seem to be a fair return upon the book-value of the various properties, the latter should be either revised or supported by a Surveyor's valuation.

The deeds relating to all mortgages, and the securities relating to whatever other investments there may be, must also be examined by the Auditor, who will do well, in addition, to require the solicitor to certify that such deeds are all in order.

It must also be remembered that there is a statutory limit to the borrowing powers of a society, which must not be exceeded. Another point to be borne in mind is that the Balance Sheet and accounts are now required to be kept in such form as the Registrar of Friendly Societies may prescribe.

It is more than probable that the fees attaching to his office will afford the Auditor no adequate remuneration for an examination conducted on such lines as those laid down; but, be

this as it may, the Auditor who—under ordinary circumstances—omits any of the precautions named would be worse than foolish.

The statutory requirements concerning, and the prescribed form for, the accounts of Building Societies will be found duly set forth in Appendix "A."

(b) FRIENDLY SOCIETIES.—The Friendly Societies Acts 1875 and 1896 contain certain provisions (for which see Appendix "A" hereto) which will guide the Auditor in his work; beyond these statutory requirements the general considerations discussed under the head of Building Societies will apply equally to the accounts of Friendly Societies, except that the different nature of the business carried on will somewhat alter the scheme of audit and assimilate it more closely to that followed in the case of Insurance Companies.

Unless the Auditor be a public Auditor holding an appointment under the Treasury, the accounts must be certified by two Auditors; but it is, perhaps, worth while to remember that the actuary employed at the quinquennial valuation need not be a public valuer.

Friendly Societies are required to keep hung up in a conspicuous place a copy of their last Balance Sheet, and to present a copy of their accounts free of charge to any member who may demand it, while every member has a right to inspect the books of the society at all reasonable times.

(c) TRUSTEE SAVINGS BANKS.—In connection with the audit of these accounts the Savings Banks Acts 1863, 1891, and 1893 will require to be studied, and in Appendix "A" will be found such portions of these Acts as affect the Auditor in the discharge of his duties. The former Act prescribes the form in which the annual return is to be made.

The remarks in connection with the accounts of Building Societies will apply, so far as they are relevant, with equal force to the accounts of Savings Banks. The examination of all the Pass Books is a most important feature, and it must not

be forgotten that there is a statutory limit both to the amount standing to the credit of any one depositor, and to the amount that may be paid in by a depositor in any one year.

A general supervision of Savings Banks is vested in an Inspection Committee appointed under the Act of 1893. This Committee is required to report to Parliament annually, and the reports that have already been submitted will be found of considerable interest to the Auditor. The present Committee is one of considerable experience: in the report for the year 1893-94 it stated—after citing the duties laid down in section 6 (6) of the 1863 Act:—"Under No. 1 of the above headings the books of the bank may be taken to comprise—

"(a) In all cases, Deposit Ledgers with one or more daily Cash Books, or other record of the individual cash transactions with depositors. These books, at least, must, therefore, necessarily be examined not less than once each half-year to comply with a minimum requirement of the Act of Parliament.

"(b) In certain cases, a General Ledger and General Cash Book, or cash summaries, in which the totals of the daily transactions are periodically worked up to show the aggregate sums deposited and repaid.

"From the reports received the examination of the detailed cash records (which 182 banks keep in duplicate) does not appear so thorough as might be desired, though doubtless there may be a considerable amount of examination not mentioned by the Auditors in their reports, nor referred to in the reports of the inspectors.

"This is especially noticeable in the checking of the daily additions of these books, or schedules, in the regular checking of the cash remittances to the treasurer by a reference to the Bank Pass Book, and of the cash balance by actual enumeration. Although there may be some details of examination which have not been defined in the Auditors' reports, the statistics obtained do not convey any very great assurance that

the scrutiny brought to bear upon the Cash Books by the Auditors in the majority of cases is a searching one, and it would thus appear that in many instances the audit in this respect ought to be supplemented.

“ The examination of the Deposit Ledgers, on the other hand, appears to be much more complete, notably the detailed postings from the Cash Book. The additions and subtractions in the Ledgers, it is true, come in for but a small share of attention; but the verification of Pass Books, so far as it extends, is a test of the accuracy of these operations, as well as, to some extent, of the postings. The calculation and addition of interest is decidedly a weak point in the management of banks where there is only one paid officer. Though checking these items can hardly, in ordinary circumstances, be held to be the function of an Auditor, still, the Auditor seems at times to be the only person available to test their accuracy. Unless the Auditor does it, no independent check is brought to bear upon the items of interest at banks where only one paid officer is employed, and errors in calculation are apt to remain undetected. Any such defect should be seen to, even if some additional expense is incurred thereby; the cost to be met, where necessary, by corresponding economies in other items of Management Expenses.

“ The most marked feature of a Savings Bank Audit appears to be the examination of the lists of balances extracted from the Deposit Ledgers. Two hundred and twenty-five Auditors certify that they have checked this independently, and eleven that they have done so with the aid of some member of the staff of the bank, a test that is not usually sufficiently independent to be safely relied upon. The importance of this operation will be appreciated when it is remembered that in most banks the total of the list is the only independent evidence of the aggregate liability of the trustees to the depositors, and it is necessary, therefore, to enable the Auditor to give a true certificate as to the amount of liabilities and assets. It also furnishes a check upon the accuracy of the postings in the Deposit Ledgers in the aggregate. As a check upon fraud the

list is of little worth, unless made accessible to depositors, and even then, before it can be put to much use, it is necessary to give every publicity to the existence and purpose of this volume by means of proper notices. Little reliance ought, therefore, to be placed on this statutory check upon fraud.

“As a rule, ‘the books of the bank’ include a General Ledger and General Cash Book in the larger and better managed and audited Banks only, but we suggest that such books should be adopted by all Savings Banks, large and small. These books, or corresponding summarised statements, should be made up not less frequently than once a month, and ought to be checked by the Auditor throughout in all respects as to additions, transfers, and postings, either continuously month by month (where a visit of such frequency is possible), or at other longer intervals.

“Other books of account relate to Stock business, in which there is but little scope for error of any serious moment.

“AUDITORS’ REPORTS.—Our experience during the past three years shows that a clear report in writing, not less frequently than once every half-year, has not always been given, a minority of banks being still content with an annual report only.

“LIST OF BALANCES.—As already stated, the examination of this list is usually well attended to.

“CERTIFICATE OF LIABILITIES AND ASSETS.—This requirement can now in all cases be conveniently complied with by the Auditor certifying the Annual General Statement of Account (which, as last amended, contains a form of Balance Sheet), as having been examined and found correct.

“BOOK OF BALANCES.—As mentioned already, this book should bear a clear certificate as to its accuracy. At nearly all banks it is so, but some cases still occur where the accuracy of this book is either not certified by the Auditor, or is certified by implication only. A form of certificate suggested by Mr. BOOKER (one of the late temporary inspectors) was given on page 74 of our First Annual Report.

"EXAMINATION OF PASS BOOKS.—It appears from the reports rendered that 178 Auditors attended at the Savings Banks from time to time to examine the Pass Books. Twenty-eight (apart from Savings Banks in Ireland, where this is compulsory) attended at periods of audit only. These figures would seem to indicate that the Auditors dispense with this test in certain cases where the trustees and managers themselves compare the Pass Books with the corresponding accounts in the Ledgers.

"One hundred and sixty-eight Auditors of Savings Banks, other than those in Ireland, gave the number of Pass Books examined, and from these it would appear that the percentage thus verified varies from 13 per cent. to 39 per cent. in the case of Banks with deposits over £100,000, the average being 18 per cent.; from 18 per cent. to 32 per cent. where the deposits do not exceed £100,000, but are over £40,000, average 29 per cent.; and from 20 per cent. to 31 per cent., average 28 per cent., where the deposits are under £40,000. At Irish Banks the average percentage is 57, and at Banks in the whole Kingdom in respect of which figures are obtainable the average percentage is 20.

"These figures give, without doubt, more favourable ratios than would be the case if the *data* were supplied in every instance. It may be safe to assume that figures are mostly given in the cases where the examination was made to an extent above the average. In several cases, too, the numbers stated to be examined include books left at the Savings Bank for audit, and in some (where the audit is not conducted at the Bank office) the Auditor states that he has examined such Pass Books as were sent to him by the actuary, practically a useless proceeding, unless coupled with extraordinary precautions. It may, therefore, be advisable to recall to mind the remarks on page 10 of our Second Annual Report to the effect that Pass Books should be compared as brought in by the customers, and not left for inspection for days and weeks at the Banks.

"OTHER DETAILS OF AUDIT.—Receipts are taken from depositors at 120 banks out of 236 from whose Auditors reports were received, and have been checked at 28, and tested at 27. There is a general feeling amongst the Auditors that it is too much to expect them to verify signatures to any extent.

"Expenses of management have been sufficiently vouched in 193 cases.

"The double check upon cash transactions with depositors appears to be complete and to be completely recorded at 204 banks out of the 236. Of these 204, 182 record the use of the double check in two independent Cash Books, while 22, having only one Cash Book, post the Ledgers at the time from the entries in the Pass Book, thus recording each transaction in two ways before the Pass Book leaves the bank. This method, although it might serve to trace any discrepancy in balancing the cash, does not afford a check on the total of the cash transactions for the day. It is only in use as a rule, however, in the smallest banks: but, to make it more complete, the accounts operated upon might be marked by inserting tags or other markers in the Ledgers, and the postings should be checked with the Cash Book, and the Cash Book summed a second time before the business of the day is concluded. The removal of all the tags, or other markers, from the Ledgers would show when all the postings had been checked.

"The double check is wanting, or is insufficiently recorded, in 32 cases out of the 236.

"Valuable assistance in the work of audit is occasionally rendered by the trustees and managers, either acting individually or by forming themselves into small audit committees. In the former manner a trustee or manager, willing to personally undertake some detail of audit, could most usefully direct his attention to the examination of Pass Books with the Ledgers of the bank. The work of an audit committee would more especially be valuable in connection with the examination of the Cash Book, and of monthly or other statements of business done. This would be particularly the case at banks

where it is not usual for the Auditor to undertake more than a half-yearly or quarterly audit, apart from any continuous examination of Pass Books that he may be called upon to make.

“We deem it of essential importance that the rules of all Savings Banks should make provision for the following matters :—

“(a) For the examination of Pass Books during the year as presented by depositors and their comparison with the Ledgers to the extent of 10 per cent. of those extant, either by the Auditor or by some other independent person or persons.

“(b) For the examination by the Auditor of the annual general statement and its certification by him, if found correct. If he is not satisfied, the Auditor should report accordingly to the trustees and managers.

“(c) For the Auditor to render occasionally, when desired, a list of work done by him in the course of his audit.”

The above extracts are of value, as showing the usual practice, in addition to that which experience has shown to be desirable.

(d) CO-OPERATIVE SOCIETIES, &c.—The consideration of the audit of these accounts need not be entered into fully. Certain statutory provisions (which will be found in Appendix “A”) must be complied with; but, in other respects, the audit will follow much upon the same lines as that of ordinary trading concerns.

Like all the classes of audit enumerated in this section, the audit of Co-operative Accounts—to be effective—must be detailed, and should be continuous, and it may be added that there is no class of undertaking in which fraud, upon the part of employees, is more general, and safeguards against fraud so few.

X. PROFESSIONAL ACCOUNTS.—(a) SOLICITORS.

—It is not easy to effectively audit the accounts of solicitors without devoting considerably more time to the task than clients would be willing to pay for, and nothing short of a continuous audit appears to meet the necessities of the case.

KAIN's System of Bookkeeping for Solicitors will often be found in use, and it certainly possesses the two-fold merit of being convenient, and of continuously showing the results achieved; but most practical men will admit that the columnar Cash Journal is an awkward book to verify. It may sound unpractical to say that every entry ought to be fully vouched (in addition to the postings and additions being checked, and the analysis column scrutinised), but it is easy to see that fraud might easily remain undetected if this precaution were omitted. Where, however, the cashier has nothing to do with the bookkeeping a certain amount of relaxation may be permitted.

Under KAIN's system there is but little danger of disbursements not being charged up to clients; but under some systems this will require careful attention.

Another system, which is in many respects preferable to KAIN's, is that described in WOODMAN's *Solicitors' Bookkeeping* (*vide* Appendix "D").

The amount included in the Balance Sheet for outstanding charges should, in general, be verified by comparison with the draft Bills of Costs. Agents' Accounts should, at all times, be carefully considered, and it is not a bad plan to compare every item of costs charged up with the press copy of the bill rendered, the object being to make sure that the full amount chargeable has been debited, for the amount asked for may not (by reason of an amount having been received on—or in—account) be always the amount that has to be debited.

To the Auditor who is accustomed to the details of a solicitor's practice, many other precautions will suggest themselves; but, unless the subject was gone into very much more

fully than the space now at disposal warrants, these matters could not profitably be discussed here.

(b) STOCKBROKERS.—A considerable amount of mystery appears to envelop Stock Exchange Accounts, and the remark has frequently been made that the audit of Brokers' and Jobbers' Accounts is altogether too technical a matter to be safely conducted by the general practitioner. The advantage of special practical knowledge on the part of the Auditor has already been freely admitted by the author, but it is contended that the desirable knowledge may be readily obtained, even by the general practitioner; and, with Stock Exchange Accounts in particular, it is suggested that the necessity of "specialism" has been greatly exaggerated.

For the audit of these accounts to be of any value, however, it is necessary that it should be of the most detailed description: the danger of error or fraud—either of which might assume alarming proportions—is extremely great, and the utmost care and circumspection are, therefore, imperative. Particular attention should be directed to the Name Ledger, and *Continuations* must also be carefully traced. The question of "splits" should also be kept in mind, as—although not a large item—it is a likely source of petty fraud.

Perhaps the chief danger in this class of audits lies in the fact that, in the great majority of offices, there exists no regular system affording a reliable internal check, and no efficient supervision. To remedy this obvious weakness the visits of the Auditor should be frequent, say, at least once during each account; indeed—although a "completed" audit is doubtless useful, as affording a reliable periodical statement of accounts—the only really efficient audit of Stock Exchange Accounts would appear to be one that is both detailed and continuous.

(c) ARCHITECTS.—The accounts of Architects are, perhaps, less frequently the subject of professional audit than either of the two classes of accounts just discussed, but this is

a state of affairs which is always undesirable, and particularly so in cases where two or more architects are practising in partnership.

The accounts do not, as a rule, involve a particularly voluminous record, and it is therefore desirable that in all cases the audit should be a detailed one. The fact that architects are frequently not business men makes it important that the Auditor should take every precaution to guard his client from loss, both through actual fraud and bad bookkeeping; it is therefore important for him to see that every item in the Cash Book is properly vouched, and, so far as possible, that all fees and commissions are duly accounted for. It may be mentioned here that, with regard to fees payable to an architect for supervising the erection of buildings, these fees are payable by way of a commission, at the uniform rate of 5 per cent., upon the value of the work done, as certified by the architect for the purpose of assessing the payments to be made on account to the builder. There will always, at balancing time, be a considerable amount of accruing fees, which, strictly speaking, constitutes an asset, but which are not actually due for payment at the time; a schedule of these items should be prepared and certified by the principals for inclusion in the accounts. Many practitioners, however, work their accounts exclusively upon a cash basis, and the plan has much to recommend it when professions are concerned.

Another point that must not be lost sight of is that, in all important undertakings, a "Clerk of the Works" is appointed to be on the spot, for the purpose of checking the material and workmanship employed by the builder. The Clerk of the Works is not infrequently appointed by the architect, but he is invariably paid by—and is the servant of—the architect's client; if, therefore, for reasons of convenience, his salary has been paid by the architect, it is important to see that it is subsequently recovered by him.

DISTRICT SURVEYORS.—Under the Metropolitan Building Acts "District Surveyors" are appointed to supervise the construction and alteration of all buildings within the Metropolitan

area. These district surveyors are invariably architects, although in the case of all recent appointments the London County Council has stipulated that those occupying the position should give up their general practice. A few of the appointments, however, still remain in the hands of practising architects. It is both desirable and convenient that, in these cases, the accounts of the district surveyor should be kept quite separate from the general accounts; and, as certain returns have to be made to the London County Council from time to time, it is convenient that the books should lend themselves to the preparation of these returns with a minimum amount of trouble. As, moreover, the collection of fees will then almost invariably devolve upon an employee, it is desirable that every reasonable safeguard should be adopted with a view to prevent the possibility of fraud.

The best system to adopt is to employ a tabular Ledger, in the same form as that in which returns have to be made to the County Council, with additional money columns on the right-hand side for the purpose of recording the receipt of fees during the current and the following year. Should any fees be still outstanding at the end of the following year these may be transferred to another folio, but the probability is that they will be so few in number as to prevent the additional labour thus involved being any serious objection. The fees actually received should be entered in the Collection Book, which is a Cash Book with no credit side to it; and it will probably be convenient to have a separate Cash Book, recording the manner in which these fees have to be accounted for to the cashier at the office, or, if thought better, a credit side could be added to the Collection Book for this purpose. In practice, however, the former method is more convenient, as the Cash Book can then be kept at a general office, and the Collection Book at the district office, where, of course, it will be continually in use.

Forms of the three books above referred to are appended below, and will be found of use, not only in connection with the accounts of district surveyors, but also with those of many other undertakings:—

THE METROPOLITAN BUILDING ACT 1855, 18 & 19 VICT., CAP. 122, SS. 52 AND 53.
RETURN FOR THE DISTRICT OF _____.

Register of all Notices served upon or delivered or made to the District Surveyor, and of discoveries made by him during the month of _____ in the year 189 , together with particulars showing the result of notices or discoveries, and the payment of the Fees due thereon.

Serial No.	Date of Notice, or Discovery	Notice from Builder or other person, or Discovery	Name and Address of Builder	Name and Address of Owner (and of adjoining property, if affected)	Situation of Building, or intended Building	Nature of Work	Height	Area	No. of Storeys	Amount of Fee p s d	No. of Account	Accounts rendered during 189— p s d	Collected during the year 19—				For Collection during 19—				Collected during the year 19—				Outst'nd'g 31 Dec. 19—		Remarks
													Date Received	C. B. Fo.	Amount Received	Abate- ments	Arrears brought forward	Accounts rendered during 189—	Date Received	C. B. Fo.	Amount Received	Abate- ments	Amount of Arrears	Reference Fo.			

Dr.		CASH BOOK,		19 .		Cr.
Date	No. of Receipt	From whom Received	Amount Received	Date	To whom Paid	Amount Paid
			£ s d			£ s d

		COLLECTION BOOK,		19 .					
Date	No. of Receipt	From whom Received	Amount Received	Serial No.	Year	Abatement (if any)	For in Return	On Account of year 189—	On Account of previous years
			£ s d			£ s d		£ s d	£ s d

(d) BARRISTERS.—The accounts of barristers are rarely submitted to a professional audit, and need not, therefore, be exhaustively considered here. As, however, barristers have rarely any knowledge of bookkeeping, and, as, moreover, the keeping of their books and the receipt of their fees are deputed to their “personal clerks,” it will be seen that the risks which they run of being defrauded are considerable; it is, therefore, reasonable to suppose that, in course of time, they will learn to appreciate the advantages of an audit as much as other business men.

Only a detailed audit, with a strict vouching of all cash items, can be regarded as satisfactory, and even this will be found of but little use unless the barrister himself keeps a Diary, or a Fee Book, which can be used by the Auditor for the purpose of vouching the Cash Book kept by the clerk. Fees in arrear should also be carefully scrutinised and inquiry made with a view to finding out the exact reason why they

have not been paid ; in any case of suspicion it would be well that a note of such outstanding fees should be forwarded to the various solicitors by the Auditor himself. It need hardly be added, however, that it would be necessary for the Auditor to obtain his client's consent to this course before pursuing it.

(e) MEDICAL MEN.—There are so many different systems of bookkeeping employed by medical men that it is difficult to afford any useful hints as to the method of audit in the space here available. It may be pointed out, however, that it is not, as a rule, either necessary or expedient for the Auditor to go behind the debits in the Patients' Ledger, which, as often as not, are fixed at round sums by the practitioner without any strict reference to the number of visits. It is desirable, however, that the Auditor should see that some efficient system of recording visits is in force, so that his client has all the facts before him when assessing the amount of his charges. The Auditor should carefully check the credit side of the Patients' Ledger, noting in particular any allowances that have been made, and he should see that all cash credited to patients has been properly accounted for.

Where payments have been made on account of patients, whether for medicines, or for consultation fees, &c., it is very important that the Auditor should see that they are properly charged up and collected in due course. Many practitioners employ one or more assistants, or dispensers, who are authorised to receive money, and where this is the case it is especially important that the system in use should, as far as possible, follow the ordinary commercial precautions against fraud. With those practitioners who supply their patients with medicines it is also necessary that the accounts of druggists, &c., should be carefully checked, and an allowance will have to be made at balancing time for the value of drugs in stock.

It need hardly be added that where horses and traps are the property of the practitioner, an adequate allowance must be made for depreciation, probably at the rate of 15 per cent. or 20 per cent. per annum. Where, however, these are "jobbed,"

it is equally important to see that the cost of hire to the date of balancing is included ; or, if this has been paid in advance, that a proportionate part is held over as an asset.

In concluding this portion of the work, the author cannot but feel that in spite of the very considerable space that has been devoted to the consideration of the special features attaching to the audit of different classes of accounts, the subject has been only very imperfectly dealt with. When, however, it is remembered that an exhaustive treatise upon the audit of any one class of accounts might easily approach the dimensions of the whole of the present work, it is hoped that it will be conceded that—however desirable it might have been to have considered the various questions involved at further detail—more could not have been reasonably expected within the limits of this volume.

CHAPTER VI.

FROM TRIAL BALANCE TO BALANCE SHEET.

That which forms the most important part of every audit, the questions of principle involved in the preparation and certification of the Balance Sheet and Trading and Profit and Loss Accounts from the Trial Balance, will now be considered. It is especially desirable that, in every audit, the principal should give these subjects his personal consideration, not merely because of their intrinsic importance, but also from questions of policy which have already been dwelt upon.

As the points now about to be discussed are the most important, so are they also the most debatable, accountants of the highest repute being by no means agreed as to the principles involved. On the other hand, it would seem to the acute observer that much of this apparent difference is, in reality, merely verbal, while perhaps more is due to the inherent difficulty that exists in casting abstract principles into a concrete form. It is, indeed, not unreasonable to suppose that, in any particular case which might be named, there would not exist among our leading practitioners any radical difference of opinion as to what the profit of a company had really been; the real cause of the confusion appearing to be that, while one maintains the true net profit to be deducible from the Profit and Loss Account, another maintains that the Balance Sheet is the only reliable basis. It would seem that, if both Balance Sheet and Profit and Loss Account be correct, it matters but little which is called the cause and which the effect.

Throughout the course of this chapter the endeavour will be to view the various questions of principle from the broadest possible standpoint. It is true that, by this means, the inherent difficulty of the considerations involved will not be escaped; but it is hoped that, at least, the treatment will be found free from catch-words and all other sources of superfluous mystification.

PRINCIPLE IN VALUATION OF ASSETS.—It being the primary object of most ordinary undertakings to continue to carry on operations, it is but fair that the assets enumerated in a Balance Sheet be valued with that end in view; before this subject is pursued any further, however, it is well to acknowledge the two *essentially different features* obtaining to different classes of accounts. Certain Parliamentary companies, constituted for the purpose of undertaking certain definite public works, are, on account of the peculiar circumstances under which they were called into existence, required to render their accounts in a special form, under what is called the **DOUBLE ACCOUNT SYSTEM**. It being required that all capital raised by these companies shall be expended in the construction of the public works (for the construction of which they were called into existence), care is taken by the Legislature to see that this provision is duly complied with; hence a special form of account, in which all moneys expended in the construction of the works is separated from the General Balance Sheet. Now, in order that this account (the Capital Expenditure Account) might perpetually show that—and how—the capital authorised to be raised (except a small margin for working capital or contingencies) has actually been spent only upon the authorised purposes it is necessary that the actual amount expended on the works alone be debited to the account, regardless of any fluctuations in value that may afterwards occur. It would, of course, have been easy for the Legislature to have provided that any fluctuation that might occur should be duly allowed for in the General Balance Sheet; but, having regard to the fact that no such fluctuation could in any way practically affect the company, so long as it

carried on business, and bearing in mind also the fact that it was contemplated that the company should *permanently* carry on business, it would appear that all consideration of these fluctuations was considered superfluous. With an eye to the future, however, and doubtless also with a view to—so far as possible—insuring the business being permanently carried on, it was provided that the company's works (which were required to be kept perpetually at the amount of their initial cost, regardless of their after value) be continuously kept in a state of efficiency, and that the cost thereof be borne out of Revenue.

It will thus be seen that the *form* of the Double Account system arose from the statutory requirement that all capital raised should be used for the carrying out of the works for the execution of which the company was created; and that the principle that, so long as the works were maintained in a state of efficiency, their actual value need not be periodically reconsidered, arose from the circumstance that it was contemplated that the work authorised would be permanently carried on.

How far these considerations need affect one's judgment concerning the valuation of the assets of undertakings not specifically covered by the statute, it will now be necessary to enquire; but it may be mentioned that, inasmuch as Accountants are not compelled to regard the Legislature as the highest possible authority in the matter of accounts, they are still free to discuss the principles involved upon their merits, even if a sense of logic compels them to admit an analogy between the accounts of Parliamentary companies and those of other undertakings.

Taking first the case of private traders, whether *sole* or firms, it is not difficult to see that, inasmuch as no man can reasonably hope to live for ever, the business of such an one is ephemeral as compared with that of a Parliamentary company. It is true that the business may, and frequently does, live longer than its founder; but, to do so, involves a change of proprietorship, and with it a *re-valuation of assets*. It will

thus be seen that, although there is no necessity to consider the contingency of liquidation (at what are expressively known as "knock-down" prices), not merely the contingency but also the eventual certainty of a re-valuation must be faced. The basis of such a valuation will be that currently known as "as a going concern," and it will, perhaps, be worth while to consider the meaning of this phrase. So far as it possesses any definite meaning—for, of necessity, the term is an elastic one—the qualification implies "at such a value as they would stand in the books if proper depreciation had been provided for"—the term "depreciation" being taken to represent the amount by which the value of an asset has become reduced by effluxion of time or wear. A fluctuation in value caused by external circumstances will, however, also require to be taken into consideration when property changes hands. It is important to remember that it is not really practicable to so maintain the efficiency of assets that no depreciation shall ever occur, and also that private firms are under no statutory requirement to *retain* the whole of the undertaking intact; the Double Account principle does not, therefore, apply to the accounts of private traders.

The accounts of what may be termed "registered" companies next claim attention. These companies, having a perpetual succession, are, perhaps, entitled to be considered theoretically permanent (although, in practice, they are generally much shorter-lived than private enterprises), and consequently the Double Account principle of stating values might be employed (but for the fact that a registered company is under no obligation to retain possession of any of its assets), if it were found practicable to say definitely what were, and what were not, Capital Assets. As a rule, such a distinction between items that are all included in one Balance Sheet will, however, be generally conceded to be confusing, and perhaps even misleading, while the fact that no particular assets can claim to be considered more permanent than the rest makes a division of the assets into two Balance Sheets usually undesirable, if not impossible. The amount, therefore, at which *all* assets are stated in Balance Sheets, except where

a special statutory provision to the contrary obtains, should be regulated—at all events to some extent—by the value of such assets.

It may, however, be added that there are certain classes of undertakings to which the application of the Double Account system is not inappropriate, *e.g.*, tramway companies and the like.

In practice, assets may generally be divided into two classes: (1) Those *with* which business is carried on, and (2) those *in* which business is carried on; the former may be named FIXED ASSETS, the latter FLOATING ASSETS.

VALUATION OF FIXED ASSETS.—The points to be borne in mind here are that wasting may reduce their value, and that fluctuation may increase or reduce their value. So far as wasting is concerned, inasmuch as it has directly contributed to the profit earned, it is clearly an expense with which profit may be fairly charged. The only question is “How?” which will be considered in full under the head of DEPRECIATION. On the other hand, fluctuation is something altogether apart from trading profit and loss, being merely the accidental variation (owing to external causes) in the value of certain property owned, but not traded in: to carry the amount of such variation to Profit and Loss Account would be to disturb and obscure the results of actual trading, and so render statistical comparison difficult, if not impossible. On no account, therefore, should the results of fluctuations affect the Profit and Loss Account. Whether or not it is desirable that such fluctuations should be revealed by the accounts *at all* will be fully considered under the head of SECRET RESERVES. The actual cost of acquiring fixed assets (*e.g.*, stamps, conveyances, registration fees, &c.) is usually capitalised. This is not unreasonable, as such expenses are clearly an integral part of the cost price of such assets.

VALUATION OF FLOATING ASSETS.—It being the essential feature of these assets that the whole aim of the undertaking is to convert—or be able to convert—

them into cash at the earliest possible opportunity, the element of immediate realisation is an essential factor in their value. The only point to remember is that, while a manufacturing profit is earned only when the manufacture is completed, a trading profit is only made when the sale is completed. Neither profit must be anticipated, but it does not appear to be invariably essential that manufacturing profit should be held over until a sale has been effected. It may be added that, where a manufacture consists of several distinct processes, and separate accounts are kept of the manufacturing profit earned under each process, there seems to be no great objection to each process being considered as a separate manufacture.

With regard to what is a trading profit, a most ingenious argument was once advanced by Sir RICHARD WEBSTER before the late Mr. Justice FIELD (*in re Horden v. Faulkner and others*), in which it was contended that the most scientifically correct method of valuing a stock-in-trade was to take it at selling prices, less the average trade profit; it being suggested that any profit realised in excess of the average was in reality a profit on buying, not on selling; and any profit realised less than the average a corresponding loss on buying. The argument passed muster at the time, appears to be plausible, and indicates a system that would doubtless prove very convenient in practice; but, unless the profit on different articles was very uniform, it would hardly be a safe one to adopt.

RESPONSIBILITY FOR VALUES.—A much-debated point is the extent of responsibility incurred by the Auditor in relation to the values set upon the assets of a company in the published accounts of the directors. The opinion arrived at in the Court of Appeal in *The London and General Bank* case upon this most important point appears to be that the Auditor incurs no responsibility whatever so long as, after exercising reasonable care and diligence, he has honestly arrived at the opinion that the accounts are correct. It will be seen, however, that this decision in no way commits itself to the expression of any particular opinion as to the mode of valuation to be adopted. In this latter respect it is interesting to note that the

draft Bill, recommended by the Departmental Committee appointed to consider the question of Company Law Amendment by the Board of Trade in November 1894, requires that the Balance Sheet of every company shall show (*inter alia*) "whether the assets are taken at cost price, or by valuation, or on what other basis they are stated, and whether any, and if so what, amount or percentage has been written off, and what other provision, if any, has been made for depreciation." At the time of writing, this recommendation has not yet become law, but it is a very excellent practice to follow notwithstanding, and has for many years past been adopted by some leading accountants.

VERIFYING EXISTENCE OF ASSETS.—Having settled a basis of valuation, the next thing would appear to be to obtain evidence of the existence of the assets enumerated in the Balance Sheet.

The evidence necessary in each class of assets would be as follows :—

LAND AND BUILDINGS: The title deeds of the property. Should the property be mortgaged the title deeds will, of course, be in the possession of the mortgagee, and an acknowledgment of this fact should be obtained from him or his solicitor, together with a statement of the amount due. Conversely, the verification of an asset represented by a mortgage is the production of the title deeds and the mortgage deed. In the case of a second mortgage the title deeds will, however, be in the custody of the first mortgagee, and here the Auditor will require to satisfy himself that such first mortgagee has received proper notice of the existence of a second charge.

STOCK-IN-TRADE: The original Stock Sheets, signed by the stock-taker, calculator, checker, and manager. Most accountants would, in addition, consider it essential that the extensions and additions be re-checked by one of their own staff, and, further, require to be satisfied as to the soundness of the principle of valuation adopted.

The Auditor's liability in connection with the valuation placed in the accounts upon the amount of stock-in-trade was considered in *The Kingston Cotton Mills* case and *The Irish Woollen Co.* case, which will be more fully dealt with in a subsequent chapter. It may be pointed out at this stage, however, that the general effect of these decisions seems to be that, where the circumstances of the case are not such as to arouse the suspicions of an ordinarily capable and diligent auditor, he is justified in relying upon the valuation of stock in-trade which has been submitted to him and certified to him by the Managing Director. In the first-named case, however, the Auditors had taken the precaution to state in their certificate that they accepted no responsibility for the valuation of the stock "which had been certified to them by the Managing Director," and as a matter of prudence it would no doubt be well for Auditors to always add this qualification. It may be added, however, that such a qualification as this would certainly not appear to save the Auditor, where he had reasonable grounds for doubting the valuation itself; whenever his suspicions have been aroused, it is absolutely necessary that the Auditor should thresh the matter out to the bottom.

INVESTMENTS IN STOCKS AND SHARES: The Auditor will require to have produced to him the scrip, certificate, bond, or other document, proving that the ownership of the investment in question is vested in his clients; and he should also require production of the broker's note, with a view to verifying the cost price thereof. In the case of Consols and other inscribed stocks, no such certificate of ownership is furnished, and in these cases it becomes necessary to obtain—from the Bank of England in the case of Consols, or the bank authorised to register the stock in other cases—a certificate that, upon the date of the accounts, such stock stood registered (or inscribed) in the names of the Auditor's clients. It is important to notice the *date* of such certificate, as it is not in itself a proof of ownership, but merely a record dealing with that particular date alone, and it differs from an ordinary certificate, or scrip, in that, in the event of a subsequent sale, it does not have to be given up.

Funds deposited as security might be taken on the certificate of responsible persons.

It may be added that if, when examined, the securities are securely sealed up in packages, it is not necessary at subsequent audits to re-examine them in detail, if the seals remain unbroken.

BOOK DEBTS: Sold Ledger balances, perhaps verified by circular to debtors (see also *Bad and Doubtful Debts* and *Discounts*).

PLANT, MACHINERY, FIXTURES, &c.: Certified inventory, which should be compared with the previous inventory, and changes noted. Additional items should be compared with invoices, and care taken to see that items sold are credited in account.

BANK BALANCE: Banker's Pass Book verified either by personal visit to Bank or by Banker's certificate of balance.

In practice it will rarely happen that the balance recorded in the Pass Book exactly agrees with the balance in the Cash Book, and a Reconciliation Account has therefore to be prepared upon the following lines:—

Balance as per Pass Book ..	£1,267	1	9
Less Cheques unpaid, viz. :—			
Dec. 16, Jones	£29	2	0
,, 21, Smith	16	5	9
,, 29, Brown	71	14	2
	—————		
		117	1 11
		—————	
		1,149	19 10
Add Payments in not credited, viz. :—			
Dec. 30, Bill No. 69 ..	£120	0	0
,, 31, Sundries	69	2	7
	—————		
		189	2 7
		—————	
Balance as per Cash Book ..	£1,339	2	5
	—————		

Where practicable it is desirable that the Auditor should see that the various adjustments which constitute the difference between the Pass Book Balance and the Cash Book Balance

are rectified in due course by subsequent entries in the Pass Book.

CASH IN HAND: Production of Cash; or, if date of accounts has gone by, by verifying Bank Account to date of audit and counting cash in hand then.

BILLS RECEIVABLE: Production of Bills (see also under *Discounts*).

WORK IN PROGRESS: Manager's certificate and Cost Accounts, especial care being taken to see that no profit is anticipated and that every reasonable provision is made for prospective losses.

The valuation of work in progress is a matter which is of such importance, as directly affecting the amount of certified profits, that it seems desirable to deal with the matter at some length. The following extracts from an article which appeared in *The Accountant* will, however, meet any difficulty which the reader might experience in connection with this matter.

"In order to arrive at a just appreciation of the position of affairs under these circumstances it is important to bear in mind the proper method of treatment when the contract is actually completed. The position of affairs when a contract has been completed is that all expenditure upon that particular contract will have been debited to an account opened for it in the Contract Ledger (or Cost Ledger), and the amount of the contract price will have been credited to the same account. This completes all the entries in the account of that specific contract. If the account shows a credit balance, there has been a profit on the contract which will be transferred to the credit of Profit and Loss Account; if, on the other hand, the balance falls on the debit side, there will have been a loss which must be transferred to the debit of the Profit and Loss Account.

"The proper method of treating a contract which is still uncompleted at the time of balancing the books is a matter which must largely depend upon what it is really believed will be the ultimate result of the contract when it is completed. If the contract is nearly finished at the time of balancing, this is a matter which can usually be foreseen without any very great difficulty or any risk of serious discrepancy between the estimate and the ultimate result. In that case the most reasonable method to adopt seems to be to make an

estimate of the amount which it will cost to complete the work (allowing every reasonable contingency for further expenses in connection therewith), and to treat this"—plus a proportionate amount to represent the profit on the unfinished work—"as a reserve to be made upon that contract, as against the contract price, regarding the balance thus shown upon the Contract Account as either profit or loss. We do not suggest, however, that these entries should be actually made in the books, but that an adjusting entry should be made in respect of all the contracts current, providing for an estimated profit or loss in connection therewith to be carried to a Suspense Account. With regard to those contracts which have been only comparatively recently commenced, no doubt the most convenient method to adopt—and one which, for all practical purposes, is reasonably safe—is to take the actual expenditure to date as an asset, and treat it in the Balance Sheet as such, without taking into account any prospective profit.

"It still remains for us to consider what is to be done with the very large proportion of contracts which are in a fairly advanced stage, and which are yet not so near completion that it is reasonably possible to estimate with any degree of accuracy how much it will cost to actually finish the work. As respects these, the very greatest demands are made upon the skill and caution of experts who are well acquainted with the particular class of business engaged upon, and reliance must, in the nature of things, be placed upon their opinion; but still, even here, there is scope for the accountant to lay down general principles which should not be departed from, and it seems to us that the principle which should be followed with regard to this particular description of contracts is that, unless the experts engaged in the trade are able to certify that, within a very small margin, they are prepared to estimate the exact cost of completing the work, no profit whatever should be taken upon the contract until it is actually finished, or until the position is such that an estimate of the cost of its completion can be arrived at.

"On the other hand, it is not always sufficient to merely take these uncompleted contracts at their actual cost, because it is well known that no inconsiderable percentage of the contracts entered into—by builders especially, and also engineers—result in a loss. It is, therefore, essential that, so far as possible, the experts should be pressed to form an opinion as to what will be the probable result of each of the contracts then under review. If they believe that in the long run it will be found that they will result in a profit, no harm can occur if the net cost to date only is included as an asset. If they are of opinion that there is a reasonable likelihood of a

loss being incurred upon any particular contract, then it is necessary that they should be pressed to estimate the amount of such loss, so far as is practicable at the present time, and the amount of such loss (whatever it may be) must be treated as having been incurred during the period in which the contract was signed. Directly a contract is signed there is a liability upon the part of the contractor to do the work in question, and if it is believed the result will be a loss to the contractor, then that loss should be treated as having been incurred when the contract was signed, and not when the work was done. Consequently, so far as it is possible to ascertain what loss there may be upon any uncompleted contracts, that loss should be debited to the period in which the contracts were entered into, and not to the period in which the contracts were completed.

“When the business is a large one—or, to speak more accurately, when the number of contracts in which the firm or company is engaged at any one time is so large that there is a reasonable prospect of the profits and losses being averaged—it is less important that the estimated losses upon losing contracts should be anticipated, inasmuch as the estimated profits upon profitable contracts are not being anticipated. As a matter of prudence, however, it is never wise that the former should be disregarded, unless it is really and honestly believed that they are of so small a nature that they will, in any event, be considerably more than outweighed by the accruing profits upon the other contracts which are not being taken to credit. To put the matter generally, all that can be done in this—as in every other—case, is to frame accounts showing results which are as accurate as, under the circumstances of the case, it is possible for accounts to be while the concern is still in the nature of a “going concern.” If, however, they are to err upon the one side or the other, it should be upon the side of caution, so that all anticipated losses are included; but prospective profits are not included until either actually realised, or in such a form that they are believed to be actually recoverable.”

SALES FOR FUTURE DELIVERY.—The question has arisen more than once as to whether a company is entitled to take credit for profit expected to be earned in respect of orders booked for future delivery. The point is naturally one of considerable importance in some industries, as, for example, with wine merchants, who frequently book orders for future delivery, and also with regard to coal merchants, cotton merchants, and the like, who enter into contracts to supply their goods for

some time in advance. The general rule which has been laid down in this work is, it is thought, unquestionably the safe one to in all cases adhere to, namely, that the profit on the sale of goods should be taken credit for at the time when the sale actually occurs; and where it is an essential portion of the contract of sale that the goods shall not be delivered until some future date, then the actual *sale* would certainly appear to be at the date of delivery, and not at the date of booking the order. Like many other matters, however, this is, perhaps, as much a matter of degree as a question of principle, and where orders have been actually booked, so that a valid contract exists upon which the customer could be sued for payment, the mere fact that the goods have not been delivered might well be overlooked and the profit taken credit for in the period when the order was booked; this, however, could certainly only be applied where the goods were actually in stock, and not when they were still unmade. Even where it is decided that credit may reasonably be taken for such future sales, it is important to remember that when payment is delayed, a reasonable rebate should be made for loss of interest, and under no circumstances could any harm be done by postponing the whole of the profit until the period when the goods were actually delivered.

OUTSTANDING ASSETS.—The point that now claims attention is the question as to how far it is the Auditor's duty to consider the propriety of including certain items among the assets that relate to transactions which, at the date of the Balance Sheet, are uncompleted.

It has been said that no profits should be taken into account that have not been actually received in cash, unless there is every reasonable likelihood that they will eventually be so received. This, of course, means that a sufficient provision must always be made for bad and doubtful debts, but it means something else besides. With some classes of transactions it is quite possible—even though the transactions themselves are not actually completed—to say with reasonable security what profit will eventually result; and, in these cases, it would

appear that the most correct course would be to apportion the profit so that each period took credit for the profit arising from its portion of the transaction. Thus, in the absence of evidence that would lead one to a contrary supposition, the profit arising from sales may safely be credited to the period in which the sales occurred, and the profit arising from manufacture similarly belongs to the period in which the articles were manufactured. The income arising from first-class investments (*e.g.*, interest on Government Stock, or Railway Debentures, or rent receivable) may likewise be said to accumulate from day to day. With regard to the latter item, however, the question of convenience intervenes; and, unless the amount involved is of sufficient magnitude to render absolute accuracy desirable, it would probably be considered sufficient if only those sums actually due were considered as assets—the amount accruing being taken as a set-off against liabilities of a similar nature, and a Suspense Account opened for the difference in a lump sum. Turning now to another class of transactions, the final result of which can only be approximately determined, no accruing profit can, with safety, be taken credit for upon the uncompleted voyages of ships, or uncompleted contracts (except in so far as previously indicated), nor for accruing dividends upon *ordinary* shares in companies, nor (under normal circumstances) for uncompleted consignments; the eventual result of all these transactions being generally of so speculative a nature that it is not safe to do more than carry forward whatever expenses may have been incurred.

Sometimes, for the purpose of providing a secret reserve, assets are intentionally under-stated, and this is a matter that will claim attention in due course: except when done advisedly, however, there is but little fear of the Auditor finding the assets under-stated. Occasionally defalcations have, by this means, been made to fall upon revenue (generally by writing off good debts as bad), but the attention thereby attracted to the existence of a leakage prevents such a course from being at all common.

OUTSTANDING LIABILITIES.—For a similar reason, there is but little fear of liabilities being over-stated: how far it is necessary for the Auditor to take special steps to guard against their under-statement is the matter that now claims attention. While the practice of “dating-forward” invoices is so common, there will always be a danger of goods being included in stock without having been passed to the credit of the Bought Ledger. “Stock-taking” statements might help to discover the omission, but they also might not. It will be a great help, therefore, if the services of the Stock-keeper are requisitioned, and he be made responsible for the production of invoices for all goods that have passed through his hands. Upon this point the decision of the Irish Court of Appeal in *The Irish Woollen Co.* case is of interest.

All Expense Accounts (*e.g.*, wages, salaries, &c.) should be scrutinised, to make sure—as far as possible—that no outstanding liabilities have been omitted.

It is a common practice to set off accruing rent, interest, &c., against insurance, rates, and other items paid in advance, and to keep a fixed sum suspended to meet whatever difference there may be. The plan certainly possesses the advantage of convenience combined with practical accuracy; but the sufficiency of the fixed sum should be verified at every audit, as the circumstances may easily vary from time to time.

The Auditor's own fee is a matter in which he will naturally be interested. There is no uniform practice, however, some preferring to debit the accounts of the period under audit with the fee, and some the period in which the audit is conducted. The latter course is naturally the most convenient where the amount chargeable depends upon the time occupied, but the former method is probably the more correct.

CONTINGENT LIABILITIES must not be forgotten. Bills discounted are perhaps the most usual source of contingent liability. Disputed claims must not be lost sight of, however, and claims for dilapidations upon premises, the lease of which has almost expired, should be anticipated, so that

the whole loss may not fall upon one year. Arrears of Cumulative Preference Dividends also come under this heading.

DEPRECIATION.—The importance of this question is considerable, and it is therefore desirable that the matter should be considered in detail. Before proceeding to do so, however, it may be well to remind the reader that—regarding Fluctuation as something wholly distinct from Depreciation—the author does not feel called upon to consider simultaneously any such contingency as an appreciation of value. Depreciation is always a charge upon Revenue, while the Fluctuation (whether up or down) affects Capital alone. The author is not prepared to admit that this distinction is contrary to the various legal decisions that have occurred from time to time; but, in any case, he would remind readers that, whatever deference or obedience is owing to the Courts, they cannot be regarded as indisputable authorities upon matters of account. From the various legal decisions that have been given it seems fairly clear that Depreciation need not be provided for against the fixed assets of a company which, in the nature of things, cannot continue its operations indefinitely, *e.g.*, a leasehold mine, a single-ship, or a land development company. The decision of Mr. Justice STIRLING in *Wilmer v. McNamara & Co., Lim.*, appears even to extend this principle to ordinary industrial undertakings, but this was a friendly action, and can hardly be relied upon as authoritative. It will, on the other hand, be far safer to assume that companies which, in the nature of things, may reasonably be regarded as being intended to permanently carry on business are required to maintain out of revenue the value of such assets as are of a wasting character.

FREEHOLD LANDS may quickly be dismissed—they suffer no depreciation. Fencing, and other similar works, would, of course, depreciate, but the item would not usually be of sufficient importance to require consideration. If, however, it became a large item, it should be treated separately as Plant (*q.v.*).

FREEHOLD BUILDINGS depreciate to an extent varying greatly according to the quality of the workmanship and materials employed in their erection. The amount of the Ledger Account will frequently include freehold land, which, as we have seen, does not depreciate; the depreciation will therefore be confined to the building itself. If the instalment plan be adopted, from $1\frac{1}{4}$ to 3 (or even 5) per cent. of the original amount may be deducted annually; if the annuity method be used a fixed sum debited to Revenue, which, after crediting interest, will write the asset down to zero in from, say, 50 to 150 years; or, if the sinking fund system be preferred, such a sum may be set aside as will accumulate to the cost of the building in that time. In each case all repairs will have to be borne by Revenue, in addition to the depreciation. With regard to the relative merits of the instalment annuity, and sinking fund methods, the two latter are distinctly preferable; although—on account of its greater simplicity—the instalment method is frequently used for short leases. The annuity system differs from the sinking fund in that the instalments are not invested; the (net) amount of each successive instalment therefore requires to be increased to compensate for loss of interest on the previous uninvested instalments. Tables showing how the amount of such instalments may be arrived at are added to the present edition of this work (*vide* Appendix “D”).

GOODWILL does not “depreciate.” On the other hand, it will generally be conceded that it is liable to fluctuations, both continual and extreme; as, however, no one would think of calling its omission from a Balance Sheet a secret Reserve, it will probably be most convenient to deal with the question of Goodwill under the present heading. As a matter of fact, Goodwill is not written down because its value is supposed to have become reduced—such a course is all but unknown. The amount at which Goodwill is stated in a Balance Sheet is never supposed to represent either its maximum or its minimum value; no one who thought of purchasing a business would be in the least influenced by the amount at which

the Goodwill was stated in the accounts; in short, the amount is absolutely meaningless, except as an indication of what the Goodwill may have *cost* in the first instance. Inasmuch, therefore, as nobody can be deceived by its retention, there is no *necessity* for the amount of Goodwill Account to be written down. On the other hand, the practice is not unusual, where sufficient profits are being made. The question is not, however, one upon which the Auditor is required to express an opinion; and, so long as the item is separately stated on the Balance Sheet, it is scarcely desirable that he should interfere with the discretion of the management, although there is, of course, no objection to his offering an opinion when he is invited to do so.

A useful work on the law and practice relating to Goodwill is included in Appendix "E."

HIRE-PURCHASE AGREEMENTS.—The general nature of a contract of this description is that, if the "tenant" (*i.e.*, the hirer) makes the necessary periodical payments regularly, the manufacturer agrees to hand over the ownership of the articles in question to him at the end of the prescribed term upon the payment of a further nominal sum. There are various other conditions which, in practice, may have some bearing upon the contract, but these are the main features that have to be taken into consideration in connection with the treatment of the contract as a matter of account.

IN MANUFACTURERS' ACCOUNTS.—It is obvious that, from the point of view of the manufacturer, it would be most improper—even although it might perhaps be technically correct—to treat these instalments as simple hire, and at the end of the term (if they have been punctually paid and a further nominal consideration paid) to treat the articles in question as a *gift* from the manufacturer to the tenant. The right treatment for the manufacturer is unquestionably for him to regard all these transactions as *sales* of the articles in question, he at the same time lending to the purchaser the

whole of the purchase-money, upon consideration of its being paid back to him by instalments with interest.

All the information which would be expressed in any hire-purchase agreement would be (1) the number of instalments, (2) the period over which they are extended, and (3) the amount of each instalment. It is obvious, however, that the manufacturer cannot treat the transaction as being a sale to the extent of the aggregate amount of the instalments, inasmuch as interest has been added and the amounts of the instalments equalised. It is, therefore, only proper for him to credit his Trading Account at the outset with the "present value" of these future repayments. In order to arrive at this figure it is, of course, absolutely essential to first of all assess the rate of interest which the manufacturer reckons to get, as a consideration for the delay in payment of the purchase price. This is, under ordinary circumstances, somewhere about 6 per cent.*; but usually the calculations are not worked out accurately, the instalments being taken at some more or less round sum approximating to what the amount would come to if worked out exactly. Still, the proper course to pursue is, no doubt, to assume a fixed rate of interest, and upon this basis to arrive at the present value of the sum of the future instalments. This may be taken as the cash value of the article sold, and the transaction treated as a sale for that amount; *per contra*, it must be regarded as an advance to the purchaser for a corresponding amount. To the debit of this Advance Account, interest at 6 per cent. (or whatever the rate may be) will be added from time to time, and the actual instalments received will be credited; so that by the time the agreement expires there is no balance to either the debit or credit of the account. An example of this account is given below:—

* In the furniture, bicycle, and kindred trades, the rate of interest might be anything from 10 per cent. up to, say, 60 per cent., in addition to the ordinary trade profit.

Dr.		A. JONES.		CONTRA.		Cr.									
Agreement No. 4,061 (10 half-yearly payments of £7 os. 8d.)															
1892				1892											
Jan. 1	To Sales Account	..	..	60	0	0	June 30 By Cash	..	..	7	0	8
June 30	" Interest	..	..	1	16	0	Dec. 31 "	..	..	7	0	8
Dec. 31	" "	..	..	1	12	10	" Balance	..	..	49	7	6
				<u>£63 8 10</u>								<u>£63 8 10</u>			
1893				1893											
Jan. 1	To Balance	..	..	49	7	6	June 30 By Cash	..	..	7	0	8
June 30	" Interest	..	..	1	9	8	Dec. 31 "	..	..	7	0	8
Dec. 31	" "	..	..	1	6	3	" Balance	..	..	38	2	1
				<u>£52 3 5</u>								<u>£52 3 5</u>			
1894				1894											
Jan. 1	To Balance	..	..	38	2	1	June 30 By Cash	..	..	7	0	8
June 30	" Interest	..	..	1	2	10	Dec. 31 "	..	..	7	0	8
Dec. 31	" "	..	..		19	3	" Balance	..	..	26	2	10
				<u>£40 4 2</u>								<u>£40 4 2</u>			
1895				1895											
Jan. 1	To Balance	..	..	26	2	10	June 30 By Cash	..	..	7	0	8
June 30	" Interest	..	..		15	8	Dec. 31 "	..	..	7	0	8
Dec. 31	" "	..	..		11	11	" Balance	..	..	13	9	1
				<u>£27 10 5</u>								<u>£27 10 5</u>			
1896				1896											
Jan. 1	To Balance	..	..	13	9	1	June 30 By Cash	..	..	7	0	8
June 30	" Interest	..	..		8	1	Dec. 31 "	..	..	7	0	8
Dec. 31	" "	..	..		4	2							
				<u>£14 1 4</u>								<u>£14 1 4</u>			

In the above example the interest is worked out at half-yearly rests, but it may be added that many manufacturers use yearly rests, even when the instalments are payable half-yearly or quarterly.

It will be seen that the arrangement which is embodied in the above account is for the payment of half-yearly instalments, the first taking place six months after the execution of the agreement. It is not always, however, that this is the nature of the transaction. It frequently happens that the manufacturer requires the first instalment to be paid on the signing of the agreement. When this course is adopted it will be found to very materially affect the "cash value" of the article, inasmuch as, there are by this means only *nine* instalments of interest to be debited instead of ten, and these in each case upon a smaller amount. For practical purposes

it may be taken that, instead of the "cash value" being £60, as stated in our *pro formâ* example, the "cash value" will be £63 10s. (approximately), if the instalments were required to be made in advance for each half-year. It will thus be seen how very important it is that these transactions should be treated upon a proper basis at the outset, for obviously a difference of £3 10s. in the price of a single railway wagon would make a very considerable difference in the amount to be taken to the credit of Profit and Loss Account, as being the gross profit upon the sales.

Attention has already been drawn to the fact that this treatment of hire-purchase transactions is a purely artificial one. There is no compulsion on the part of the tenant to continue paying the instalments if it suits his purpose better to cancel the agreement and return the wagons. While the agreement continues, however, he is liable for the wagons being kept in good repair, and has to continue to punctually pay the instalments arranged. The result of this is that, even if the tenant chooses at some subsequent date to cancel the agreement and return the wagons, in the majority of cases the result will be an additional profit to the manufacturer. But this does not necessarily follow if the wagons were new at the date of executing the agreement and are returned, say, one year from that date. In that case there may be a loss, and to that extent the treatment just described may be said to be unduly favourable, having regard to the worst possible contingencies. But it is so rarely that these agreements are cancelled in the first year or so that this consideration may be disregarded; it being practically certain that the few cases in which it occurs will be very much more than averaged by those in which default is made at a later period of the currency of the agreement, in which case the manufacturer reaps a profit.

In point of fact it is generally admitted that, at all events after the first two years have been completed, the tenant possesses some value in his agreement, even if he decide to discontinue the payments; and it is by no means unusual for

him either to sell his rights under the agreement to some other person who is desirous of acquiring the wagons upon a hire-purchase system (obtaining the manufacturer's consent to the transfer), or for the manufacturer himself to pay some cash consideration to the tenant if the latter decides to abandon his rights under the agreement and return the wagons in good condition. That being so, it may be taken that the asset standing in the manufacturer's books, as being the amount due upon the loan of the purchase money for the wagons, is a good asset for that amount, even if default is made by the tenant. It must not be forgotten, however, that if default is made and the wagons are returned they are no longer new, and, moreover, they are not worth to the manufacturer himself even the "cash value" which he originally charged for them. They cannot, therefore, be taken back as an asset upon that basis necessarily. They must be taken back at what is their true (wholesale) value and an adjustment made accordingly, the tenant's account being credited with such true value, and any difference, whether to the debit or to the credit, written off to Profit and Loss.

As, however, the cancelling of agreements will be found to result in a profit in most instances, the method described above may be taken as being a perfectly safe one for the manufacturer to adopt in normal cases.

The same system of accounting will apply equally well to the books of furniture, bicycle, or sewing-machine dealers, &c. ; but it is to be noted that in these cases the rate of interest is higher (as already stated), that the period rarely exceeds three years, and that the instalments are usually weekly or monthly. The interest is, however, almost invariably worked out at yearly rests.

IN HIRERS' ACCOUNTS.—It now becomes necessary to consider how these transactions should be dealt with in the books of the tenant or hirer. Except in the case of railway wagons acquired upon the hire-purchase system, the treatment of

these agreements in accounts does not often arise, as other classes of goods are, as a rule, only hired by private individuals who do not generally have occasion to keep accurate accounts of their personal transactions. Retailers do, however, occasionally purchase tricycles for trade purposes on hire-purchase agreements. In view of the fact already mentioned, that the ownership of the goods remains with the manufacturer until the completion of the whole transaction, it might be argued that, strictly speaking, the whole of the instalments should be charged against revenue. On the other hand, it is obvious that this would very unduly affect the profits of the earlier years, for the simple reason that the instalments on a hire-purchase agreement are very much heavier than upon a simple hiring agreement (being, as a rule, something more than twice the amount), so that during the earlier years the undertaking would appear to be losing money by entering into hire-purchase agreements at all; whereas this is by no means the case in reality, the instalments being a wise capital outlay for the purpose of acquiring fixed assets at a future date. It will thus be seen that, even if the very strictest view of the position of affairs be taken, it is not necessary to charge against revenue a larger proportion of the hire-purchase instalment than the amount for which the use of the wagons in question could have been obtained upon simple hire. Even this is really too much to charge, because the wagon companies naturally look to make a larger profit out of hiring than out of hire-purchase agreements. It therefore becomes necessary to go into the matter very much more exhaustively; and, assuming that almost all these transactions are negotiated upon a basis of 6 per cent. interest by half-yearly rests, it is thought that the following table, which shows the cash value of a wagon upon which half-yearly instalments of £5 are payable for any period from one to five years, will be found of use. As already stated, the usual term of these agreements is five years, but a very considerable number are for 3, 3½, or 4 years.

TABLE showing cash value of debt repayable by half-yearly instalments of £5 each (rate of interest = 6 per cent., calculated at half-yearly rests).

Number of Instalments unpaid							Cash value.		
							£	s	d
2	(Agreement one year to run)	..	..	..	..	..	9	11	5
4	(" two years " )	..	..	..	..	..	18	11	9
6	(" three " )	..	..	..	..	..	27	1	9
8	(" four " )	..	..	..	..	..	35	2	1
10	(" five " )	..	..	..	..	..	42	13	2

From the above table it will be seen that, assuming a hire-purchase agreement were entered into under which the tenant paid £10 per annum by half yearly-instalments during five years, the cash value of the wagon must be taken as being £42 13s. 2d., allowing interest at the rate of 6 per cent. with half-yearly rests. At the end of the first year (that is to say, after two instalments have been paid) the amount standing to the debit of Loan Account in the manufacturer's books will be reduced to £35 2s. 1d., at the end of the second year to £27 1s. 9d., at the end of the third year to £18 11s. 9d., and at the end of the fourth year to £9 11s. 5d., which amount is extinguished at the end of the fifth year. To a certain extent, this position of affairs may be taken as reciprocal, *i.e.*, the difference between the original cash value and the reduced cash value in the manufacturer's books from time to time may be taken as being the investment of capital by the tenant in the property in question.

There are, however, other considerations to be borne in mind; and for the sake of bringing these more prominently forward, it seems desirable to take a concrete example. Take the case of an agreement entered into on the 1st January 1894, by which the tenant agrees to make seven half-yearly payments at £8 6s. 6d. (the first being due on the 30th June 1894), the interest being assumed to be 6 per cent. with half-yearly rests. By reference to the foregoing table it will be found that the cash value of the wagon in this case is £51 17s. 6d. The following table may now be compiled, showing what proportion of the instalments paid during each year is in respect of interest upon the outstanding debt due

to the manufacturer, the balance of the instalments being consequently the proportion which has to be capitalised. The column upon the extreme right in the following example shows the accumulations upon the "Wagons Purchase Account" at the close of each year:—

Date	Amount of Instalment	Interest on Outstanding Debt	Proportion to Capital	Total to Wagon Purchase Account to date
	£ s d	£ s d	£ s d	£ s d
31st December 1894	16 13 0	2 18 2	13 14 10	13 14 10
" " 1895	16 13 0	2 1 5	14 11 7	28 6 5
" " 1896	16 13 0	1 3 7	15 9 5	43 15 10
30th June 1897	8 6 6	4 10	8 1 8	51 17 6
	£58 5 6	£6 8 0	£51 17 6	

A careful examination of the above table will show that when the agreement is completed on the 30th June 1897 the tenant will have paid in all £58 5s. 6d., of which £51 17s. 6d. has been allocated to capital, and £6 8s. to revenue. The point which next claims attention is as to whether any further charge to revenue is necessary, and if so how much.

REPAIRS.—The question of repairs should on no account be allowed to confuse the treatment of the hire-purchase agreement itself. The proper course is either to debit each year's Profit and Loss Account with the actual repairs incurred, or else to debit the Profit and Loss Account and credit Repairs (Fund) Account with the best estimate of the normal charge for repairs, and to debit the latter account with the cost of such repairs as are actually executed. This course has the advantage of averaging—as far as possible—the charge to revenue in respect of these items; but, in view of the fact that both the railway companies themselves and the Board of Trade regulations are very strict as to wagons being kept in a thoroughly effective state of repair, it is probable that in the long run these repairs will be found to average themselves, particularly when the tenant possesses wagons of different ages. But whichever method be adopted, the treatment of the repairs should be kept quite distinct from the statement of the gradual purchase of the wagons on a hire-purchase agreement.

DEPRECIATION.—The next question which calls for consideration is that of depreciation. Up to the present the treatment indicated has been a question of right and wrong, rather than one of individual preference or discretion, but depreciation is entirely a question of individual discretion. In the first place, there is the precedent afforded by the statutory form of accounts with regard to railway companies, which suggests that *no depreciation whatever need be provided*, but that the proper course is to renew worn-out wagons out of revenue. When any large number of wagons are held by the same owner this is no doubt by far the simplest course to pursue, as the charges to revenue will be found to average themselves very closely. But if only a few wagons are owned, it may be found that the charges to Profit and Loss arising from their renewal are unequal, and it will then be found preferable to adopt some means which will have the effect of averaging them. Then, again, there arises the consideration that railway wagons, when owned by the class of persons who would naturally acquire them upon hire-purchase agreements, are “fixed assets,” and “not floating assets.” Therefore, even in the case of ordinary joint stock companies, there is no statutory obligation requiring that depreciation should be provided for from year to year. It will thus be seen that the whole matter is (subject to the articles of association of the particular company concerned) entirely one of separate choice, but that is no reason why the effect of the various methods which may be adopted under different circumstances should not be considered and their respective merits contrasted.

It may be taken at the outset that a railway wagon has a very long span of life. Being made up of a number of interchangeable parts, it is quite possible, in the ordinary course of repairing, to entirely renew the wagon from time to time; that being so, the time never really arises when the asset itself is absolutely worthless and cannot be tinkered with any longer. But those who are desirous of making ample reserves against revenue for every possible risk will probably prefer not to rely too much upon this fact, but will assume a length of life upon the part of the wagons which is likely to be realised in all but

abnormal cases, as, for instances, where accidents occur. So far as the author has been able to ascertain, the minimum life of a wagon may be put down at sixteen years, and many are used for a very much longer time. But, for those who wish to provide an ample reserve in the nature of depreciation, it is worth while to regard the limit as sixteen years, because by this means they will be building up a reserve which will be available in the event of that particular pattern becoming obsolete by reason of further improvements, and also in the event of the destruction of one or more wagons by accident. There are various methods by which the "cash value" of a wagon may be written off, and it is desirable that the precise effect of each should be fully studied.

Perhaps the most favourite method of writing off depreciation, in the case of articles which from time to time require repairs, is to adopt a fixed percentage upon the amount of the reducing annual balance. The effect of this method is to write off much heavier sums in the earlier years and smaller sums in later years of the asset's life, the object of this being to compensate for the fact that the amount of necessary annual repairs will probably be upon the increase. If it is desired to extinguish the value of an article in sixteen years by writing a fixed percentage off the reducing balance, it will be necessary to adopt a rate of depreciation of about 17½ per cent. The following table is prepared upon this basis with regard to the example already shown above :—

Date	Interest	Depreciation	Total Charge to Revenue	" Book " value of Wagon at close of year
	£ s d	£ s d	£ s d	£ s d
1894	2 18 2	9 1 6	11 19 8	4 13 4
1895	2 1 5	7 9 10	9 11 3	11 15 1
1896	1 3 7	6 3 7	7 7 2	21 0 11
1897	4 10	5 1 11	5 6 9	24 0 8
1898	..	4 4 1	4 4 1	19 16 7
1899	..	3 9 5	3 9 5	16 7 2
1900	..	2 17 2	2 17 2	13 10 0
etc.				

With reference to the figures appearing in the last money column above, it will be noted that for the first four years the amount is increasing, while afterwards it is reduced. The

reason for this is that during the continuation of the hire-purchase agreement a portion of the instalments is in respect of capital, therefore the amount of the capital is increased during this period in spite of the amounts which are credited to that account and debited to Profit and Loss for depreciation. It will further be noticed that at no time does the value of the wagon appear in the books at more than £24 os. 8d., although the original value of the wagon when new was £51 17s. 6d., and, further, that during each of the first three years the total charge to revenue exceeds £7. This figure of £7 is mentioned in this connection because that is approximately the amount which would be charged for simple hire, and it is obvious that under no circumstances can it be really proper to charge more against revenue than the amount of simple hire, because, in addition to getting the use of the wagon, which is all that is paid for in the case of simple hire, the tenant is also gradually acquiring the ownership of the wagons themselves. It will thus be seen that the above system is one which operates very unfairly upon the earlier years' profits, and is also one which unnecessarily reduces the value of the wagons, for it cannot be said that the value of a wagon which is kept in thorough repair is reduced more than 50 per cent. in the course of four years.

Another method of providing for depreciation is to write off annually one-sixteenth of the original "cash value" of the wagons. If this method be adopted in the present case it will be found that the rate of depreciation must be approximately $6\frac{1}{4}$ per cent. per annum upon the original value, and the following table shows the figures corresponding to those already mentioned, if this alternative system be adopted:—

Date	Interest	Depreciation	Total Charge to Revenue	"Book" value of Wagon at close of year
	£ s d	£ s d	£ s d	£ s d
1894	2 18 2	3 4 10	6 3 0	10 10 0
1895	2 1 5	3 4 10	5 6 3	21 16 9
1896	1 3 7	3 4 10	4 8 5	34 1 4
1897	4 10	3 4 10	3 9 8	38 18 2
1898	..	3 4 10	3 4 10	35 13 4
1899	..	3 4 10	3 4 10	32 8 6
1900	..	3 4 10	3 4 10	29 3 8
etc.				

Upon this system it will be seen that in no year does the total charge to revenue exceed the amount which would have to be paid for simple hire; but that during the continuance of the hire-purchase agreement the charges to revenue are very much larger than afterwards, being during the first year nearly twice what they become after the agreement has run out. It will further be noticed that the maximum value at which the wagon appears in the tenant's books is £38 18s. 2d., or about 75 per cent. of its original value when new. From many points of view this is a very much better method to adopt than the preceding, seeing that apparently the assets are not overstated in the hirer's books, nor are the charges to revenue liable to serious fluctuations; but even this system is one which cannot be looked upon as being so correct as to leave no room for alternative methods.

A third method is, during the continuance of the hire-purchase agreement to only write off depreciation upon the instalments debited to capital. This method can certainly be justified in theory by the argument that it is obviously unreasonable that the tenant should be expected to provide in his own Profit and Loss Account against depreciation of property which does not belong to him; and, although this view might be thought to be somewhat specious, it is well worth while to consider how the various annual charges to revenue will work out if this basis of calculation be adopted. It will be found that, in order to extinguish the asset entirely at the end of 16 years, it will be necessary to somewhat raise the rate of depreciation if this system be adopted, as compared with the $6\frac{1}{4}$ per cent. which was necessary when each instalment of depreciation was equal. A simple calculation shows that $6\frac{3}{4}$ per cent. during the continuance of the agreement, and $6\frac{1}{2}$ per cent. after its expiration, will produce the desired result; and the following table shows the charges to revenue during each of the first seven years after the commencement of the hire-purchase agreement, the facts being taken to be the same as before:—

Date	Interest	Depreciation	Total Charge to Revenue	"Book" value of Wagon at close of year
	£ s d	£ s d	£ s d	£ s d
1894	2 18 2	18 6	3 16 8	12 16 4
1895	2 1 5	2 13 1	4 14 6	24 14 10
1896	1 3 7	4 2 1	5 5 8	36 2 2
1897	4 10	3 10 1	3 14 11	40 13 9
1898	..	3 7 10	3 7 10	37 5 11
1899	..	3 7 10	3 7 10	33 18 1
1900	..	3 7 10	3 7 10	30 10 3
etc.				

The obvious objection to this method—and, indeed, the only one which can be seriously raised—is that the charges to revenue *increase* during each of the first three years (that is to say, during the continuance of the agreement), for, although the charge for interest decreases as the amount due to the manufacturer is reduced, the charges for depreciation naturally become heavier and to a much more largely increasing extent. It will also be noticed that at the end of the fourth year the "book value" of the wagon appears to be at a somewhat higher rate than under either of the preceding methods, being £40 13s. 9d. at the end of 1897 (*i.e.*, when the wagon is four years old), as against £38 18s. 2d. under the $6\frac{1}{4}$ per cent. method. But this difference is not so serious as to afford a reason for throwing this method of calculation upon one side altogether, more particularly as it will be remembered that under each case the same amount is written off to revenue within the 16 years, which is supposed to be a minimum life for the asset in question, while the actual distribution to the charges of revenue *during* the life of the asset is always a matter of individual discretion rather than one upon which hard and fast rules can be laid down.

There is, however, distinct room for objection to the charges to revenue increasing during the continuance of the hire-purchase agreement, and in order to avoid this the method has sometimes been adopted of averaging the instalments to revenue during this period, so that at the expiration of the hire-purchase agreement the same amount stands to the debit of the Asset Account as upon this last-mentioned method, but

that the instalments *during* the continuance of the agreement are equal. The following table shows how this may be accomplished :—

Date	Interest			Depreciation			Total Charge to Revenue			" Book " value of Wagon at close of year		
	£	s	d	£	s	d	£	s	d	£	s	d
1894	2	18	2	1	9	10	4	8	0	12	5	0
1895	2	1	5	2	6	6	4	7	11	24	10	1
1896	1	3	7	3	4	4	4	7	11	36	15	2
1897		4	10	4	3	1	4	7	11	40	13	9
1898	..			3	7	10	3	7	10	37	5	11
1899	..			3	7	10	3	7	10	33	18	1
1900	..			3	7	10	3	7	10	30	10	3
etc.												

. It will be seen that, under this last method, during each of the first four years the charge to revenue is equal ; but that, after these first four years—that is to say, after the hire-purchase agreement has expired—a smaller amount is required. The amount of the debit of the Asset Account at the end of 1897 is the same as under the preceding method, and the amount in both cases is entirely extinguished at the end of 16 years.

From many points of view it is thought that this latter is really the most convenient method to adopt under most circumstances, but, as already stated, the question of apportioning revenue charges among the various years of the estimated life of the asset is entirely a matter of individual discretion, and one in which the greatest latitude must be allowed, provided the apportionment is made in good faith. There is thus really no reason why exception should be taken to the amount chargeable to revenue being equalised during the whole of the 16 years, instead of being equalised as between the term of the hire-purchase agreement and the remainder of the life of the asset—or the expected life thereof: the great point in all cases, of course, being to avoid an unduly favourable, or unfavourable, result being attached to any particular year.

The whole question, however, is one upon which the greatest variety of opinion obtains, and the author has therefore purposely abstained from holding up any particular system

of calculation as being the "correct" one to adopt, merely indicating the precise effect of each of the alternative methods possible, and leaving the choice of method to those who are really responsible for its adoption—that is to say, to those who have the direction of the undertaking concerned; for although it may be very desirable for the Auditor to point out the effect of the various methods, the choice of method certainly does not lie with him, but with the directors, and the only duty of the Auditor is to see that the apportionment is reasonable and *bonâ fide*.

HORSES invariably depreciate, and—if heavily worked—very rapidly. The rate of depreciation will probably vary between 15 and 25 per cent. on the starting balance of the account. Until experience has shown the actual rate of depreciation, it will be safer to arrive at the result by a re-valuation (which, with horses, can be more accurately done than with most things), and where only a small number of horses are employed (say 20 or less) the re-valuation should always be resorted to, if only as a check upon the rate of depreciation employed.

INVESTMENTS need not be depreciated unless of a wasting nature, such as shares in Single-Ship Companies. As to how far it is desirable that fluctuations in their value should be considered, the reader is referred to the paragraph on Secret Reserves (*postea*).

LEASEHOLD LAND AND PREMISES.—The premium paid for leases may be regarded as the purchase-money paid for a terminable annuity of the difference between the annual value of the property and the annual charges. In short-term leases the readiest method will be to charge a proportionate part of the term against each year's Revenue; but the method is too rough to be employed if the term exceeds, say, eight or ten years. In the case of longer leases the annuity, or sinking fund, plans, which were discussed under the heading "Freeholds," should be adopted. Almost invariably the termination of a lease finds the late lessee liable to a heavy claim for

dilapidations; the amount of this claim will frequently amount to one year's rent, or even more, and it is therefore a convenient and prudent course to adopt to deduct about one year from the unexpired term of the lease before making the depreciation calculations. All repairs are, of course, chargeable to Revenue; but they may be averaged by the temporary or permanent employment of a Repairs (Fund) Account through which revenue is charged with a fixed amount annually, the difference between the actual expenditure and the annual charge being brought forward as a liability, or (more rarely) as an asset.

Before leaving this point it is well to bear in mind that, in the case of exceptionally long leases or exceptionally badly built premises, it is often necessary to increase the annual charges for depreciation beyond the usual rate, or to make an unusually ample reserve for future repairs.

LICENSED HOUSES present some rather special features. The goodwill attaching to the licence gives the lease or freehold of licensed premises a market value greatly in excess of the real value of the buildings. To be properly considered, the value of the premises and the licence must be separated. The former should be depreciated in the usual way, leaving the licence alone to be considered. A licence on freehold premises does not depreciate, but a licence on leasehold premises passes away with the premises, and must therefore be depreciated like a lease. A licence may at any time be lost—either for misconduct or for no reason—but this is a contingency outside the scope of depreciation. It may, however, be provided against by insurance, which would appear to be a most prudent course to adopt.

MACHINERY depreciates by wear and tear, and by becoming obsolete. In addition to charging all repairs and (partial) renewals to Revenue, from $7\frac{1}{2}$ to $12\frac{1}{2}$ per cent. should be written off annually from reducing balances. Boilers, which depreciate more rapidly, should be reduced from 10 to 15 per cent. per annum. Tools are most conveniently dealt

with by means of a re-valuation. It is desirable that a sound practical opinion be obtained as to the precise rate to be adopted in any particular case, and a thorough re-valuation from time to time is very desirable.

MINES undoubtedly depreciate in direct proportion to the amount of mineral extracted. By a singular inconsistency of the law, however, no depreciation need be provided for by a mining company before declaring a dividend. Where depreciation is provided the correct method appears to be to write off annually such proportion of the total cost (less residual value of plant) as the year's output bears to the estimated contents of the mine, or—in the case of a lease—such proportion of the total cost as the year's output bears to the estimated total output during the lease.

PLANT, other than machinery, generally runs comparatively little risk of becoming obsolete, and a deduction of from 5 to 7½ per cent. will therefore usually suffice. Furniture and fittings should, however, be subjected to a somewhat higher rate. In both cases an occasional re-valuation will be desirable.

The correct method of arriving at the value of plant purchased on HIRE-PURCHASE AGREEMENTS has already been dealt with (*vide ante*).

PATENTS are virtually leases of a monopoly, and although it is possible that some value—in the nature of goodwill—may remain after the patent has run out, it seems desirable that the cost of a patent should be written off within the course of its life. Renewal fees seem to correspond to ground rents. Where a patent has not been purchased, but remains the property of the original patentee, it is very undesirable that the item should be treated as an asset at all, except to the extent of its actual cost in fees, &c.: such a course would seem to be every bit as artificial as a similar treatment of goodwill, which *sans dire* is a latent asset in every paying concern. A similar mode of treatment will apply to COPYRIGHTS, except that their

commercial value has usually expired long before the copyright has run out. (*See further under "Publishers' Accounts."*)

SHIPS undeniably depreciate, although the rate at which they do so is so variable that no general rules can be given that would prove of any practical utility. The amount of depreciation is usually certified by a competent engineer, and therefore—so long as his report looks plausible—the Auditor is relieved from undue responsibility. As already stated, it is almost unknown for a Single-Ship Company to provide for depreciation, it being, presumably, considered inadvisable to allow a large depreciation fund to accumulate in the manager's hands. So long as the Auditor's certificate makes it perfectly clear that no depreciation is being laid aside, and so long as the Courts see no illegality in such a course, there does not appear to be any valid objection, from an Auditor's point of view, that is not outweighed by the resultant advantages.

THEATRICAL PLANT, &c.—Although there can be no reasonable doubt that theatrical scenery, "props," and other stock-in-trade is liable to depreciation, it is probable that few accountants would care to accept the responsibility of settling the actual amount. So far as the author has been able to ascertain, there is no uniform practice in vogue; but a periodical re-valuation appears to be adopted in many cases, and will very likely recommend itself to the Auditor as being perhaps the safest course. COPYRIGHTS and PERFORMING RIGHTS, when not purchased upon "sharing" terms, will also require to be dealt with; but, unless there appear to be very good reasons for believing that a "Revival" at no very distant date would prove remunerative, it would probably be considered safest to regard the whole cost as a mounting expense. Unless the Auditor is acting on behalf of a company or a creditor, the best plan will, no doubt, be to leave the whole question to his client's discretion.

REPAIRS will, in all cases, require to be charged against Profit and Loss; but, with a view to equalising profits, it is

a very good plan to charge a fixed sum to Profit and Loss, and to credit that sum to a "Repairs (Fund) Account," against which account the actual repairs will be debited. Except in very special cases, however, a debit balance on Repairs (Fund) Account should not be passed as an asset. If the amount expended upon repairs is below the average of previous years, it may be desirable to re-consider the value of the property itself.

LANDLORD'S FIXTURES.—In the case of plant, machinery, and fittings erected upon leasehold property, it is important not to lose sight of the fact that, so far as these become landlord's fixtures, the minimum rate of depreciation permissible is one that will entirely write off the book-value by the time the lease expires.

MR. ADAM MURRAY'S VIEWS.—The general question of Depreciation is one of such great importance that the views of so experienced an accountant as Mr. ADAM MURRAY, F.C.A., can hardly fail to prove of very considerable interest. The author accordingly approached Mr. MURRAY upon the subject, and he has very kindly allowed him access to a lecture upon "Wear and Tear and Depreciation," which was delivered at Liverpool in 1887. Mr. MURRAY has, with all his usual kindly courtesy, given his consent for this lecture to be reprinted in these pages, and as some time has elapsed since it was first read it is thought that this permission will be as greatly appreciated by the readers of this work as it has been by the present author, for it is probable the paper will be now seen by the majority for the first time.

Mr. ADAM MURRAY's paper is as follows:—

"In submitting a short paper on the above subject it is intended only to offer some general remarks; to give a few cases in illustration, and to refer to others upon which a difference of opinion exists.

"At the outset it will be convenient to make a distinction between Wear and Tear and Depreciation. Depreciation is a comprehensive term, including wear and tear; but the two are distinct elements, and may be considered separately.

"*Wear and Tear* may be defined as 'diminished value arising from use,' as in the Income Tax Act 1878, 41 Vict., cap. 15, section 12, under which a deduction was for the first time allowed in the assessment of profits under Schedule D, such allowance being in respect of 'diminished value by reason of wear and tear.' Although described in the Act to be for 'wear and tear,' yet in the form of Income Tax Return No. 11A, under Schedule D, the word 'depreciation' has been adopted; still, the Income Tax Commissioners and Surveyors limit the allowance to wear and tear.

"The word 'depreciation' is almost universally used in the deduction from property, plant, and machinery accounts, and the corresponding charge made to Profit and Loss Account, but in the case of most ordinary trading concerns 'wear and tear' might properly be substituted for 'depreciation.'

"Under the head of 'wear and tear' it is proposed to deal with the ordinary charge made in Trading Accounts for the use of buildings, machinery, and plant.

"It is equally an item in calculating the cost of production, as is the payment for labour and for materials consumed.

"In ascertaining the cost of materials and stores used, the stock is taken at the end of the period against the stock at the beginning, and purchases during the period, the difference being the consumption.

"In the case of buildings and machinery a deduction is made, but the effect is the same as taking the property and plant into stock at a reduced amount, or at an increased amount if the additions during the period have been in excess of the deduction for wear and tear.

"Although the process differs, yet the result attained is the same, the cost of materials used being *ascertained*, the charge for the use of buildings and machinery being *estimated* without reference to change in value from other causes than use. It would not be a safe basis to take the value, as there is a fluctuation in the value of buildings and machinery irrespective of use.

"In order that the cost of production should be approximately correct for the purpose of fixing the selling price, or for comparison with the market price, it is important that wear and tear should neither be over nor under-estimated. For instance, the cost of building a cotton mill and furnishing it with machinery may some years ago have been equal to 30s. per spindle. Such a mill may now be built fully equipped with machinery having all the latest improvements at about 20s. per spindle.

"In the case of an old mill it would be misleading to charge more for wear and tear than would be sufficient in the case of a new mill, consequently an old mill, unless it had been written down in the books at a high rate for wear and tear, might stand at a sum relatively higher than that of a mill built in more recent years.

"On the other hand, in the times of large profits (now passed away) it was not unusual to write off altogether the cost of the mill and machinery, or to reduce it to an amount much below the value. In such case the element of wear and tear might be lost sight of, or under-estimated, and thus the spinner would be deceiving himself as to the cost of production.

"In the present days of bare profits it is of the utmost importance that the cost should be fairly estimated, and the mill proprietor should look at the question of wear and tear between himself as a landlord on one hand and as a tenant on the other.

"It is not unusual in the cotton manufacturing districts for a manufacturer to rent a weaving shed with looms and power at an annual rent of so much per loom, and an owner occupying his mill should in like manner charge his business with a rent equal to interest on the value of the buildings and machinery, together with a charge for wear and tear beyond the cost of repairs, renewals, and maintenance, the outlay in respect of which should be debited to the Trade Account as part of the ordinary expenses.

"Much confusion and uncertainty exists in the Property and Machinery Accounts of many manufacturing businesses, by reason of the way in which wear and tear and renewals are treated. It is not unusual to make a deduction from the Property Accounts for wear and tear, and then to add to those accounts the outlay not only in the nature of additions and extensions, but also for renewals; the result not unfrequently being that the Property Account is upheld at a sum far beyond its real working value, and as a consequence the profits are apparently more than the actual profits. A safer course, in my opinion, is to make a deduction from the property for wear and tear, charging such deduction to the Profit and Loss Account, as well as the entire cost of maintenance, thus increasing Property, Machinery, and Plant Accounts only by the actual additions thereto.

"The accounts of railway companies and gas companies are kept on this principle, with this difference, that there is not any charge for wear and tear beyond maintenance, it not being required in the statutory form of accounts for those companies that there should be any such charge, and consequently in the Revenue Account actual maintenance is included only.

“In the case of railway companies owning steamships, there is a charge which is called ‘depreciation,’ but it would be more correctly described as ‘provision for renewal of steamships.’

“Some municipal corporations owning gas works have exceeded their powers in charging the Profit and Loss Account with wear and tear where there is not any such requirement in the special Acts conferring borrowing powers for gas works purposes, and the rate-payers are thus placed in a less advantageous position than that of shareholders of a gas company, in addition to which a sinking fund has also to be provided out of the gas profits of a municipal corporation.

“In making a deduction for wear and tear it is the practice with the majority of companies to follow the course usual with private-trading concerns.

“Some, however, do not take wear and tear into account beyond the actual outlay.

“If it is objected that the cost of maintenance and renewals over a number of years may be unequal, this difficulty is met by estimating what amount annually is likely to be required for such purposes, and by charging the Profit and Loss Account with such amount, carrying the same to the credit of a ‘Renewals and Repairs Account,’ debiting the outlay from time to time to such account.

“It is not proposed to suggest what the rates for wear and tear should be in various businesses. These must be estimated by those conversant with and able to judge from practical knowledge of each particular business. It is sufficient to lay down what is believed to be a sound general principle, *i.e.*, to maintain existing works and plant out of revenue, and in addition to charge Profit and Loss with a deduction from property, machinery, and plant in respect of wear and tear.

“It is customary to make the deduction by a percentage rate from the cost *as reduced from time to time*, and not from the original cost. There is thus a larger amount for wear and tear charged in the early years, but the practice is preferred, seeing that in the later years, when the charge for wear and tear is less, there will be an increased expenditure for repairs and renewals as the unexpired term becomes shorter.

“If the life of an article, subject to wear and tear, was a known quantity, then the question of charge would be simplified. In such case interest would have to be added to the cost and balance cost, from year to year, writing off an annual sum to the Trading Account, by which cost and interest would be either extinguished altogether, or reduced to the value of old material at the end of the term.

"Let us now look at depreciation as distinguished from wear and tear; as the converse of appreciation, and as a separate element.

"Numerous and varied cases will suggest themselves.

"In addition to ordinary wear and tear, manufactories and works are subject to depreciation arising from

"(a) Improvements by which machinery may become of little more value than that of old material

"(b) The less profitable state of trade.

"(c) The reduced cost of labour and materials.

"Where a manufacturer occupies his own property (as is almost invariably the case) as a prudent man he ought to have a reserve taken out of profits for these contingencies.

"It is an excellent plan to have an inventory of principal machines, tools, &c., kept in such a way as to show wear and tear deducted, as well as the reduced cost, in detail. By this means if part of the machinery becomes superseded and has to be realised, the loss is readily ascertained and can be charged to Contingent Fund. This is not a merely theoretical system, but is in actual practice; of course, in such a case the loss or difference having been written off, any substitution would be chargeable to Plant Account, as in the case of an addition. Such an inventory would be of great use, as affording the means of making a comparison between the reduced cost of machinery as in the books, and the then working value.

"The proprietor of a mill or works built twenty years ago would find that as between himself as landlord and as a tenant he would now have to charge himself with rent only on the reduced value, and the difference between the present value and the cost would be a loss of capital and not loss as a trader.

"It may be considered refining too much to make this distinction, still it is a convenient rule to apply, and assists in arriving at the correct principle in cases which frequently arise.

"Another case which properly comes under the description of depreciation is that of a leasehold property. If land is held under lease for twenty-one years, to be surrendered at the end of the term with the property upon it, the amount paid to the lessor and the cost of buildings erected by a lessee with interest thereon can be dealt with without any doubt as to the correct principle in such case, the term being fixed and not uncertain as in the case of machinery.

"Let us suppose that the land for the term of lease cost £1,000

"and the buildings erected by the lessee 2,500

£3,500

“If the lessee occupies the property for the purpose of his business he has to charge his trading with an annual rent, which he will ascertain in the following manner, the value of money being taken at 5 per cent. We find from one of Inwood's tables that the amount of £1 with interest at 5 per cent. for twenty-one years would be £2.786, therefore the amount for £3,500 would be £9,751. Then we see from another of the tables that £1 per annum at 5 per cent. would in twenty-one years amount to £35.7193; then as £35.7193: £9,751 :: £1: £273, thus giving the annual rent or instalment as £273.

“If the land had been leased at £50 per annum then the charge to the business would be the rent and the annual instalment to write off the £2,500 (the cost of the buildings) and interest. In either case the annual charge is equal to the rent between the proprietor as a landlord and as a tenant. A Ledger Account of the cost, interest, and instalments, with annual rests, would, of course, be closed by the last instalment.

“Another case which comes within the experience of many of us is that of a colliery.

“A field of coal is leased, say, for thirty years subject to royalty on coal as it is won. The lessee expends on ‘Sunk Capital Account’ £100,000, in opening up and sinking pits. The charge to the Profit and Loss Account, in addition to the royalty on the coal, will be the annual instalment to be written off in the same way as in the previous case.

“Taking money at 5 per cent. the £100,000 would in thirty years amount to £432,190, £1 per annum at the same rate would amount to 66.4388; then as 66.4388: £432,190: : £1: £6,505.08, this being the annual charge to be made by the lessee in his Profit and Loss Account as the annual rent which would be charged to him had the outlay been made by the lessor, he being content to have his expenditure back in thirty annual instalments, including principal and interest.

“The effect of wear and tear or depreciation taken out of the profits of a business is, of course, to increase the balance of floating assets over liabilities, or to reduce the excess of liabilities over floating assets, and it may not be unsuitable to refer to the proper application of money arising therefrom.

“In the case of works mortgaged, or advances by bankers or others, it would, of course, be wise to reduce any such liability. If there were not any such claims to meet, then it would be well to take the money out of the business rather than expend it in additions or extensions.

"A common error has been to use available funds of this kind for the purpose of building additional works or factories instead of investing the money to meet the cost of substitutions. When such time arrived there had been years of bad trade, and thus the means were not forthcoming, the consequence being embarrassment, if not ruin.

"And now a few observations as to Accounts and Balance Sheets in relation to the subject under consideration.

"As a means of affording information to those interested, it is desirable that wear and tear and depreciation should be shown as a deduction from time to time in the Balance Sheets of all trading concerns, in the same way that additions to property and plant are usually set forth. In exceptional cases the error is made of having a Depreciation Account as a *fund* on the debit side of a Balance Sheet; the usual practice, however, being to charge wear and tear and depreciation against profits and to reduce the Property or Machinery Accounts correspondingly. It is misleading and erroneous to look upon such an entry in the Balance Sheet as a *fund* represented by assets. The property and machinery being of less value ought to be written down. The amount of wear and tear or depreciation is, no doubt, represented by money if taken out of profits; but it is only a change between fixed and floating assets, the latter being correspondingly increased.

"It is not usual to charge Profit and Loss Account in anticipation of wear and tear or depreciation, and so create an actual fund; but if such be the case it would be more intelligible if any transfer of the kind was made to the credit of such an account as 'Renewals and Repairs Account.'

"It has from time to time been suggested that there should not be any deduction made from profits for depreciation, but that it should be left to partners and proprietors to decide for themselves how much of the profits or dividends is in respect of interest, and how much principal.

"There appear to be several objections to such a mode of dealing with the accounts of trading concerns, although in some cases it is the practice.

"In the case of property, machinery, or plant subject to depreciation, such as:—

Manufacturing concerns,
Leasehold colliery,
Steamship company, &c.,

the Balance Sheet would be misleading, inasmuch as the capital of the company would apparently be represented by property and assets, when, in fact, they had greatly depreciated, and in some cases would cease to be of any value whatever.

“In a company, the shares of which had not any Stock Exchange quotation, and where sellers and buyers had to arrange prices between themselves, intending purchasers would not have the means of satisfying themselves as to the value of the shares.

“It is not sufficient to say that existing shareholders are aware that part of the share capital is being repaid while outsiders would be in ignorance thereof. Dividends in such cases (consisting of both principal and interest in uncertain amounts) would not be any criterion of value.

“Directors generally would not approve of such an anomalous and objectionable mode of making up the accounts of their company.

“Accountants would hesitate, or indeed refuse, to sign such a Balance Sheet, inasmuch as it did not ‘represent the true position of the company.’

“Having had experience of wear and tear and depreciation in various forms, their influence should be used to secure adequate deductions in order that Balance Sheets may be accurate, so that objection could not be taken to them.

“It would be most unsatisfactory and dangerous if property and assets were not written down, money arising from depreciation being applied in discharge of liabilities, or in reduction of share capital.

“It is greatly to be feared that in many cases where machinery (from the speed at which it is run) is subject to a high rate of wear and tear, sufficient allowance is not being made, and that, consequently, dividends include some portion of the capital where the shareholders are under the belief that they consist of profits only.

“Such a theory as has been suggested would, if recognised, lead to much inconvenience in the case of trust estates where there were life interests. Trustees could not be expected to take the responsibility of making a division of dividends between life-tenants and those entitled in remainder, and it would be most unsuitable to leave them in a position of having to decide how much should be considered income, and what portion a repayment of principal.

“We now come to the conclusion of a paper in which the intention has been to deal with a few leading features of the subject under consideration, including the following:—

“The distinction between Wear and Tear and Depreciation.

“The deduction from Buildings, Machinery, and Plant for Wear and Tear to be in addition to the cost of maintenance, chargeable to the Trading Account.

“A Renewals and Repairs Account, to equalise the charge to Trading Account.

“Inventory of Plant and Machinery.

“Accuracy of Balance Sheets.

“The illustrations given are few in number, but the principle suggested, if approved, may be applied in any variety of circumstances. The subject is an important one, and sufficient may have been said to create a desire to follow it out in more complete detail.”

In a letter to the author Mr. MURRAY adds: “I do not know that there is anything in it (the above paper) which I would now alter, although I might add to it. I am more and more impressed with the importance of provision for renewals being placed upon a sound and systematic basis, having regard to the life of machinery, &c., and charging outlay against provision.” In exemplification of his views Mr. MURRAY refers to the accounts of the Lancashire and Yorkshire Railway, in which—in addition to the actual cost of repairs—a fixed sum is charged to revenue for replacements, the actual expenditure upon replacements being charged against various “Renewals Funds,” while the balance from time to time appears in the General Balance Sheet as a liability. It is believed that most railways adopt a similar system, but it is most unusual for the published accounts to actually show what has been done in the way of providing for future renewals.

DEPRECIATION TABLES.—It will have been noticed that, where a rate of depreciation upon machinery, &c., has been stated in the preceding paragraphs, it has usually been stated as being “upon the reducing balance”; the advantage of this method is that the larger instalments are written off at first, when the machinery is new and its earning power greatest, but it is important to remember that the ultimate results attained by the two methods are widely different. Thus, if 5 per cent. per annum be written off £100 for twelve years the residual value will be £40, but if the same result is to be arrived at by calculating depreciation upon the reducing balances the rate to be employed must be $7\frac{1}{2}$ per cent. For the purpose of displaying similar comparative results under varying circumstances, the author has compiled a little work entitled *Comparative Depreciation Tables*, which, it is thought,

will be found of value. Some further interesting information upon the subject will also be found in the author's *Bookkeeping for Accountant Students*, while a table on the "annuity" system for use in connection with freehold and leasehold properties is included in Appendix "D."

PROVISION FOR BAD AND DOUBTFUL DEBTS.

—Unless the outstanding Book Debts are extremely numerous, it is desirable that the Auditor should go over the list in company with his client, or the Managing Director, or some equally responsible authority, and settle the amount of loss to be provided for. Where the number of accounts renders this course impracticable, a certified list of amounts to be treated as bad, and a statement that the provision made is sufficient, signed by the aforesaid responsible authority, should be supplied to the Auditor.

Although it is very undesirable that an insufficient provision be made, it should—on the other hand—be remembered that, when once a debt is written off, its chance of being eventually collected is greatly discounted; and, further, that there is at least the possibility of its not being accounted for, if collected: hence the advisability of adopting the system already described (*vide* pages 60 to 62).

In connection with this subject, the judgment of the Irish Court of Appeal in the *Irish Woollen Co.* case (note Appendix "B") will be found of interest.

OUTSTANDING DISCOUNTS.—It is customary to provide for the usual cash discounts, upon both Book Debts and Trade Creditors, by means of a Suspense Account. Where, however, the amount is uncertain (by reason of the variable nature of the payments) and the difference between the two sides is but slight, the provision might be omitted without any great harm being done—indeed, it is a very open question whether the profit or loss—as the case may be—ought to be anticipated. *Trade* discounts are, however, a very different matter and should always be provided for.

Here again the decision *In re The Irish Woollen Co.* case may be consulted with advantage.

DISCOUNT ON BILLS is a matter requiring careful treatment; as, if the dealings in Bills are large, the amount involved may easily reach considerable proportions. It has been stated that every credit transaction involves the consideration of interest or discount—a statement which is, doubtless, theoretically unassailable, but practically inconvenient. As a matter of fact, a result almost ideally correct may be obtained with a tithe of the trouble. If the terms upon which goods are sold are, say, $2\frac{1}{2}$ per cent. discount at one month, or a three months' acceptance net, it might, at first sight, appear that the trader gives credit at 15 per cent. per annum interest, but in all probability he would only allow 3 per cent. (or at most $3\frac{1}{2}$ per cent.) for cash, which is altogether a different rate. The real terms would thus be: 35 days' average credit (20th of month to 20th of month, payable 10th of following month), 3 per cent. or $3\frac{1}{2}$ per cent. discount; 65 days' average credit, $2\frac{1}{2}$ per cent. off; 126 days' average credit, net. It will be seen that these terms do not actually represent any definite rate of interest, and further—the choice of terms being with the debtor—that no absolutely accurate proportionment can be made.

In such a case as that named a better plan cannot be adopted than to suspend $2\frac{1}{2}$ per cent. on all open accounts, and carry over the Bills Receivable net. A similar method would apply to outstanding liabilities and Bills Payable. Where, however, a Bill has been discounted, or renewed, at interest, or granted for an exceptionally long term at interest, the question of interest should be no longer ignored, unless the amount involved be trifling.

In the case of BANKS and other FINANCIAL HOUSES interest (which is no longer obscured by trade profits, but is itself the source of all profit) must, of course, be *always* taken into account.

DIRECTORS' FEES.—In the absence of any special arrangement contained either in the articles of association or in the minutes of general meeting, directors are entitled to no remuneration in respect of their services. The Auditor will require to see therefore, before passing any such remuneration, that provision is contained therefor in the articles of association, or else that the remuneration has been voted by the shareholders in general meeting. He would also require to see that the amount which the directors have received is in accordance with such provisions. Proper vouchers should be given by directors for fees received by them, and (unless specially so prescribed) the Income Tax payable upon such fees should—if paid by the company—be deducted from the sums payable to the individual directors.

The case sometimes arises, in connection with companies which are not doing very well, of directors foregoing the whole or a portion of their fees. In such a case as this it is desirable that the Auditor should inquire as to whether they have actually foregone the right to claim such fees, or merely foregone their immediate payment. In the latter case the amount still due should, of course, be included among the liabilities in the Balance Sheet.

PRELIMINARY EXPENSES.—In the Balance Sheet of almost every young company this item will be found among the Assets. It will probably surprise few to learn that, as the law is at present interpreted, registered companies are under no obligation to write off this item out of profits. It is, however, not only very desirable but also very usual to write off the amount of the Preliminary Expenses within the first three or five years; and the Auditor will do well to recommend the adoption of such a course. With Parliamentary Companies, on the other hand, Preliminary Expenses are an item of Capital Expenditure, and—as such—are retained upon the accounts for ever.

It must not be forgotten that, in every case, the Auditor must thoroughly verify the amount of this item by reference to vouchers and contracts. In particular, he should make sure

that the company has made no payments that the promoters undertook to pay, or which—for other reasons—may appear improper. It is not an unknown occurrence for Directors' qualifications to be paid for out of Preliminary Expenses.

RESERVE FUNDS.—It is very generally conceded, and therefore need not be discussed at length in these pages, that it is not—under ordinary circumstances—desirable that a Reserve Fund be specially invested. Where, however, the fund is specially raised for a specific purpose (*e.g.*, the redemption of debentures) its investment would appear to be desirable, for the purpose of insuring its being available at the appointed time. In certain other cases, as named in Appendix "A," Reserve Funds are required by statute to be specially invested; and, in these cases, it is, of course, the Auditor's duty to see that this has been done. Where the Reserve Fund exists for the purpose of strengthening the credit of the company—as in the case of Banks—it is doubtless desirable that it should be invested in first-class securities; but it is no part of the Auditor's functions to interfere with the Management in this respect. The whole subject is, however, dealt with very fully in the following chapter.

Unless there is any special provision in the articles of association, there is nothing to prevent directors from transferring the whole or any portion of the amount standing to the credit of Reserve Fund to the credit of Profit and Loss Account, for the purpose of increasing the amount of profits available for dividends. Where such a course is being pursued, the Auditor should, however, take steps to acquaint the shareholders with the facts, unless they are sufficiently obvious on the face of the accounts.

INSPECTION OF MINUTE BOOK.—The question frequently arises, and is the source of no little contention, as to whether an Auditor has the right to inspect the Minute Book recording the proceedings at board meetings. It is thought, however, that this right cannot be disputed, inasmuch as it is clearly the duty of the Auditor to certify to the accounts after

having examined "the books of the company," and certainly the Minute Book is a "book of the company," inasmuch as it is one of the few books which every company is required by Act of Parliament to keep. Theoretically, at least, it is necessary that the Auditor should carefully examine the whole contents of the Minute Book, but in practice it is thought that this rule may frequently be relaxed, and reference only made in respect of items upon which the Auditor is in doubt, or with regard to which he requires further elucidation. It need hardly be added, however, that in this respect—as with regard to all other matters where the Auditor prefers to take a short cut in his work—he does so at his own risk, and the risk in this particular connection is that he may fail to become acquainted with some contingent liability or contract, which would materially alter his views with reference to the accounts which he is called upon to certify.

REDEEMABLE DEBENTURES.—Where debentures, redeemable at par or at a premium, have been issued at a lower rate, it is essential that a proper reserve be made to meet the deficit; and it will be the Auditor's duty to see that a sufficient provision is made.

FORFEITED SHARES, not re-issued, should be separately stated on the Balance Sheet, as a dividend declared would not be payable in respect thereof. Such shares may at any subsequent date be re-issued at any discount not exceeding the amount per share already received, and when so re-issued the amount already paid (or so much thereof as represents profit) may be conveniently dealt with as a premium upon issue, and would be best credited to Reserve Fund; but the matter is in the discretion of the directors—subject, of course, to the approval of the shareholders. The Auditor should always make a point of seeing that the minutes as to forfeiture are *prima facie* in order.

FLUCTUATIONS IN ASSETS AND SECRET RESERVES.—This most debatable subject is approached with considerable diffidence. Very much can be (and has been) said

upon both sides of the question, making it a most difficult thing to say what is really the correct course to adopt in any particular case ; and, if the question be complicated, even when a particular instance is judged upon its own merits, how much more difficult is it to lay down any general rules of universal application.

The object of all secret reserves is to equalise dividends, or to equalise apparent profits ; and, in the case of banks and similar institutions, it must be admitted that, were accounts published showing considerable fluctuations in the amount of profits earned, the result might readily be to produce a feeling of disquietude which was altogether unwarranted by the actual facts. More particularly in the case of banks largely affected by fluctuations in exchange does it seem desirable that the temporary effect of such fluctuations should be excluded from published accounts.

The understating of assets in profitable years (which is the ordinary means of providing a secret reserve) clearly contemplates, however, the possibility of their being written up in less profitable years, when it may be desired not to disclose the fact that the profit earned has been less than usual, or perhaps even insufficient to cover the proposed dividend.

Opinions differ greatly as to the extent to which the formation of secret reserves is permissible ; but it is thought that, within reasonable limits, the matter is one resting with the directors rather than with the Auditor, so long as there is no suspicion of bad faith. It is when it is sought to have recourse to a secret reserve by writing up the assets which have hitherto been undervalued that the position requires the most serious consideration of the Auditor, and upon this point a few precedents may prove of interest.

Some little time since the accounts of the London General Omnibus Company, Lim., were criticised, because the Balance Sheet contained upon the assets' side an item of considerable magnitude described as "Times," representing, apparently, the assumed value of the Goodwill attaching to the times of the

company's omnibuses. In order to meet this criticism the item "Times" was eliminated, and the value of the company's leasehold premises written up to a corresponding extent, it being stated that—even at this enhanced valuation—the leaseholds appeared at a figure lower than their intrinsic value. The matter was not made the subject of legal proceedings; but, in view of the attention which it attracted, it may, it is thought, be safely assumed that it was found impossible to attack this policy upon legal grounds.

A more important precedent is the case of *Bolton v. The Natal Land & Colonisation Company, Lim.* (*vide* Appendix "B"), in which it was held that the company might properly declare a dividend out of current profits under the following circumstances:—A large bad debt had been made in previous years, and the loss so shown upon the accounts was cancelled by writing up the value of the company's lands to a corresponding extent. It may be mentioned, however, that, in the case of a land company, its lands—which are held for purposes of re-sale—are floating assets, and it was expressly stated by Lord (then Mr.) Justice ROMER, in the course of his judgment, that it was "not correct, in estimating the profits of a year, to take into account the increase or decrease in the value of the capital assets of the company."

With regard to the position of the Auditor generally, it would appear that, in the absence of *mala fides*, he incurs but little responsibility. He should, however, be very careful about the good faith with which the valuations or re-valuations are made, and although he has no power to influence the management in the exercise of their *bonâ fide* discretion, yet it would appear to be clearly his duty, in cases of doubt, to sufficiently acquaint the shareholders with the facts of the case to enable them to intelligently exercise their own discretion as to whether or no they will pass the accounts in the form in which they are presented to them. Thus, where the assets are stated below their certainly-known value (forming a secret reserve), or above their certainly-known value (forming a secret deficit), at least the bare fact should be mentioned in the Auditor's certificate. Again,

there are limits to the extent with which a secret reserve should be played with, for the sake of equalising dividends; and it is very undesirable that valuable assets should be omitted from the Balance Sheet *in toto*, because in such a case the Auditor is very liable to omit to verify their existence. In some Balance Sheets a note is appended to the effect that certain (specified) assets have not been included. Such a course appears to remove the most weighty objections that can be raised against the reduction of valuable assets to zero, but it does not altogether justify the course adopted.

FOREIGN EXCHANGES.—Very little would be gained by stating half-a-dozen, or so, cut and dried rules with regard to the correct treatment of accounts involving the expression in sterling of transactions occurring in a foreign currency. The subject has been defined by Mr. GOSCHEN, who is probably one of the highest authorities now living, as a “most simple” one “of most difficult application”; it may therefore be said (without any disrespect to the reader) that the difficulty is, not to state general rules, but for the reader to know how to apply them. Those who desire to consider the subject theoretically are therefore recommended to carefully study GOSCHEN’S *Theory of Foreign Exchanges*, while they will also find some food for further reflection in Volume XVII. of *The Accountant*.

With regard to the practical treatment of the subject, it is, perhaps, desirable to add a few words, in view of the fact that the whole question is one which is very rarely properly understood. Considerations of space do not justify a minute discussion of the subject, but probably the following explanation will be found sufficiently clear for general purposes.

Taking the case of an English company carrying on business in Brazil as merchants, the books recording all the transactions in Brazil would be kept there, and from time to time a Trial Balance would be sent over to the head office for incorporation in the company’s accounts. These Trial Balances would naturally be in the currency of the country, in which currency all transactions would have occurred. It only remains to be

explained that remittances received from London would have been entered at the actual amount which they realised in the foreign currency. Such a Trial Balance, upon being received at the head office, would be converted into sterling at an average rate of exchange (as shown in the accompanying example), the only exception being in the case of the Remittance Account, which would be stated at the actual amount appearing in the Head Office Ledger, the difference between such actual amount and the amount as calculated upon the average rate being debited or credited to Exchange Account. The balance shown in the Brazilian books to the credit of Head Office Account is the balance standing at the commencement of the period under review, all remittances either to or from London having been posted to the Remittance Account; it therefore follows that the balance of the Head Office and the Remittance Accounts in the Brazilian Trial Balance will agree as to amount with the corresponding balances in the London Trial Balance.

TRIAL BALANCE—BRAZILIAN BOOKS (1M. = 10½D.).

	M	M	£	s	d	£	s	d
Capital Expenditure	50,000	..	2,187	10	0			
Local Debtors	200,000	..	8,750	0	0			
Local Creditors .. .. .	..	50,000	..			2,187	10	0
Local Expenses	40,000	..	1,750	0	0			
Local Income .. .. .	..	150,000	..			6,562	10	0
Local Stock	35,000	..	1,531	5	0			
*Head Office Account .. .. .	..	235,000	..			10,281	5	0
*Remittance Account	100,000	..	4,300	0	0			
Exchange .. .. .	..	..	75	0	0			
Cash	10,000	..	437	10	0			
	435,000	435,000	£19,031	5	0	£19,031	5	0

TRIAL BALANCE—LONDON BOOKS.

	£	s	d	£	s	d
Share Capital .. .. .	..			12,500	0	0
*Brazilian Account	10,281	5	0			
*Remittance Account (M. 100,000) .. .. .	..			4,300	0	0
Office Expenses	1,000	0	0			
Cash	5,518	15	0			
	£16,800	0	0	£16,800	0	0

The two Trial Balances may, therefore, be now incorporated, and the four items marked “*” struck out without in any way disturbing the result.

Before proceeding to close the London books, however, it is necessary, if the average rate of exchange be higher than the rate ruling at the date of closing the books, that a reserve should be made for loss upon floating assets in Brazil, less the local floating liabilities. The local assets stand nominally at £10,718 15s., and the local liabilities at £2,187 10s., the difference being £8,531 5s. If, at the rate of exchange for the day, one milreis be worth 10d. instead of 10½d., a reserve has to be made for possible loss on exchange of £406 5s. It is not expedient that this reserve should be expressly shown in the published accounts of the company, and it is therefore usual to deduct the amount to the debit of the Nominal Account from the gross profit, and to deduct the reserve to the credit of the Suspense Account from the amount at which the assets in the foreign country are stated in the Balance Sheet. When these adjusting entries have been made, the Profit and Loss Account and Balance Sheet of the company appear as stated below:—

PROFIT AND LOSS ACCOUNT

Dr.

for the year ended————189—.

Cr.

	£	s	d		£	s	d
To Office Expenses	1,000	0	0	By Gross Profit (less reserve			
„ Loss on Exchange	75	0	0	for loss on exchange)..	4,406	5	0
„ Balance, being net profit	3,331	5	0				
	£4,406	5	0		£4,406	5	0

BALANCE SHEET, ———— 189—.

<i>Liabilities.</i>			<i>Assets.</i>		
	£	s d		£	s d
Capital Account	12,500	0 0	Capital Expenditure in		
Sundry Creditors in Brazil..	2,187	10 0	Brazil	2,187	10 0
Profit and Loss Account—			Stocks, Debtors and Cash		
Balance available for			in Brazil (less reserve) ..	10,312	10 0
Dividend	3,331	5 0	Cash at London Bankers..	5,518	15 0
	<u>£18,018</u>	<u>15 0</u>		<u>£18,018</u>	<u>15 0</u>

The above is the usual method of dealing with foreign exchanges in accounts ; but another and more theoretically correct system is fully considered in the author's *Bookkeeping for Company Secretaries*.

ULTRA VIRES.—It is a question of some nicety as to how far an Auditor is expected to concern himself with the validity of the transactions that come under his notice. It may be taken that, in general, the Auditor is not constituted a judge of the conduct of the directors in their administrative capacity; and that, so long as the accounts are in order, and in accordance with such statutory provisions as may affect the particular undertaking, and its articles of association (or their equivalent), the Auditor need not concern himself with questions which his professional training has not especially qualified him to solve. It is clear, however, that when the Auditor is aware that irregularities have been committed, it becomes his duty to report the whole circumstances to the shareholders.

It is perhaps worth noting that such registered companies as are regulated by Table A of the 1862 Act have no power to declare interim dividends. This is a provision that is, in practice, frequently violated.

FORM OF ACCOUNTS.—In the audit of private accounts it is usual for the Auditor to recommend the particular form in which the accounts shall be cast, but in the case of registered companies it is by no means unusual to find a clause in the articles of association expressly providing that the Auditor shall have no power to dictate the form in which the accounts shall be stated. In such a case, therefore, the Auditor need not concern himself with the consideration as to whether or no the form adopted is the most suitable one under the particular circumstances of the case; but, if he is convinced that the form adopted is one calculated to mislead, he should not hesitate to modify his certificate accordingly.

Nevertheless, the whole question is one of considerable interest, and accordingly it has been thought desirable to deal with it at some length in the following chapter.

Where a statutory form of accounts has been provided, the Auditor should see that the accounts are prepared in accordance with that form, or as nearly in accordance therewith as circumstances will permit. The form of Balance Sheet laid

down in Table A is, in practice, but rarely followed in its entirety, even by those companies that have been registered without special articles. This is a point that Auditors would do well to bear in mind.

FORM OF CERTIFICATE.—It is not the intention, here, to give any definite forms of certificate. Individual preference will always largely rule the form adopted by the Auditor; and, so far as the author's opinion goes, he sees no particular advantage in a crystallised form to be used upon every occasion. Where, however, it is specially enacted that the Auditor shall certify to certain definite statements, it is very desirable that the form adopted should make special reference to the accuracy of these statements. Where the particular circumstances of the case make it desirable that a special report should be submitted, the accounts should not be certified, or even certified "subject to report," but rather be either left unsigned altogether, or else inscribed in some such terms as the following:—"I have audited these accounts, and specially reported thereon this — day of — .189— (Signed) A. B., Chartered Accountant, Auditor." There is then no possibility of suppressing the report without, at the same time, suppressing the certificate.

It is important to remember that the Auditor cannot relieve himself of his responsibility to the shareholders by reporting privately to the directors that his certificate is to be taken with certain. (specified) reservations.

In a recent case (*re J. Hargreaves, Lim.*—*vide* Appendix "B") it was held to be no part of an Auditor's duty to communicate direct with the shareholders, when the directors had kept back the fact that he had refused to certify the accounts.

CHAPTER VII.

FORM OF ACCOUNTS AND BALANCE SHEETS.

It has already been very clearly stated that, in general, the Auditor is not responsible for the form of the accounts which he certifies. The consideration of the form that such accounts should properly take is, therefore, not strictly a matter within the scope of the present work. Still, it is none the less true that, as a matter of fact, Auditors are frequently asked to settle questions of form; and although in the case of limited companies' accounts they will often be only prudent if they decline to accept a responsibility that properly devolves upon the directors, there can, it is thought, be no possible objection in the case of the accounts of private firms. Moreover, it cannot be denied that the subject is at all times one upon which the Auditor should have definite and well-matured opinions.

In view of the importance of the subject, therefore, a special chapter has been set aside for its due consideration. To a great extent the views now about to be expressed have already been set forth in a lecture delivered by the author in 1893, but many topics have been enlarged upon and brought up to date, while, on the other hand, much that appeared to be of an elementary nature has been suppressed.

It may be stated at the outset that the accounts which it is now proposed to deal with are those which are ordinarily

certified by the Auditor—viz., the Trading Account, the Profit and Loss Account, and the Balance Sheet.

OBJECT OF TRADING ACCOUNTS.—Taking first the account which in different undertakings is variously called the Trading Account, the Manufacturing Account, the Working Account, the Profit and Loss Account, and the Revenue Account, the first point to be considered is the real object of preparing such an account. This may be stated as follows:—

For the purpose of showing—

First, the amount of business done in each of the various branches in which business is carried on ;

Secondly, the amount of expenditure in each of the branches necessary for the carrying on of that business ; and,

Thirdly, the amount of surplus, or profit, or loss, as the case may be, which arises from the carrying on of the particular business.

The object of the information is doubtless primarily to ascertain the amount of ultimate profit or loss, but beyond this there is also the further object—which perhaps is only fully appreciated by those skilled in accounts—of comparing the corresponding items of various periods, with a view to ascertain how income may be increased and expenditure reduced, or, on the other hand (so far as possible), *why* income has become reduced, and *why* expenditure has increased.

It will thus be seen that the efficiency of this account depends very materially upon the skill with which the income and expenditure have been distributed over the various headings employed, and consequently it becomes necessary to discuss the nature of the various headings under which the items of this account should be divided.

It goes without saying that, inasmuch as this account details the summarised result of the transactions recorded in the books,

its exact nature will very materially depend upon the precise business which is being carried on, and it therefore becomes necessary to further consider the subject under the headings of various classes of business.

COMMERCIAL ACCOUNTS.—Taking first commercial concerns (which undoubtedly represent the great majority of the undertakings which are now being considered), it will be found that the transactions consist in the buying of goods and the selling thereof, either in the precise form in which they were purchased (as in the case of traders), or in an altered form (as in the case of manufacturers); in both cases there being the further expenditure incidental to the carrying on of the undertaking.

ACCOUNTS OF TRADERS.—Dealing first with the Accounts of Traders, which are naturally of a simpler nature than those which require to be kept by manufacturers, the first circumstance to note is the method usually in vogue by which a trader computes the amount of advance upon purchase price which it is necessary for him to charge for his goods in order to obtain a remunerative return for his labour, and this excess is very generally known by the term of “Gross Profit.” It would be very difficult to find an exact definition of the term “Gross Profit,” inasmuch as the items from which it is calculated will be found to vary in different undertakings; but seeing that the whole business of a trader is based upon the calculation of a fixed percentage of gross profit upon each different class of goods dealt with, it necessarily follows that any form of accounts which does not recognise the existence of such a thing as “Gross Profits” fails to afford the trader that assistance which he is entitled to look for from his accounts, and consequently to a very great extent fails to justify its existence.

It has been argued by many experienced accountants that gross profit cannot be considered to arise until such things as rent of warehouse, salaries of warehousemen, &c., have been debited to the Trading Account; but as it is the almost

universal custom of traders to reckon their percentage of gross profit entirely from the cost price of their goods (although, as a matter of convenience, they actually make the calculation backwards from their selling price, it would seem that, however correct it may be in theory, it is in practice nothing more than pedantic to include in this first section of the Profit and Loss Account anything more than "Sales" and the closing "Stock" upon the credit side, and "Purchases" and the opening "Stock" upon the debit. It is, of course, quite possible to argue that the resultant credit balance means absolutely nothing at all; but, even if this is so, the fact remains that unless the account is so prepared it is impossible to see whether the aggregate transactions of a period actually result in the percentage of gross profit which the trader had been calculating upon throughout that period; and, therefore, whether it is thought best to call the balance of this first section "Gross Profit," or to employ the indefinite term "Balance," the overwhelming weight of advantage lies in bringing the account—in this respect at least—into accord with the custom of every trader, and so enabling him to ascertain whether during any period he has actually achieved the results which he anticipated.

In the next section of the "Profit and Loss Account" may be included all items of income and expenditure relating to the business except those of a financial nature (such as discount, interest, and income tax), which latter may be more conveniently relegated to the third and last section of this account, which also shows the disposal of the profit among the proprietors or shareholders, as the case may be. Interest upon borrowed capital or upon partners' capital should also be included under this last section, and also directors' fees; but the salary of a managing director or of a working partner more properly belongs to the second section, which bears the bulk of the general expenses. The utility of a division between the second and third sections comes in in this way. If the amount of business and the rate of expenditure have been fairly constant, the balance shown at the foot of the second section will

also be constant, irrespective altogether of any fluctuation in the amount of capital which the firm may have had at its disposal; and this is extremely useful both for the purpose of seeing how far the net profits of a concern have been affected by purely financial reasons, and how far by commercial reasons, and also on account of the convenience it affords if it should at any future time be decided to convert the venture into a limited liability company. The following *pro formâ* accounts are drawn up upon these lines, and represent a good form for a firm of traders:—

Cr.

TRADING ACCOUNT (FIRST SECTION) FOR THE YEAR ENDED 31ST DECEMBER 1892.

Dr.

	Stock on 1st Jan. 1892		Purchases for the year		Gross Profit		Total		Sales for the year		Stock on 31st Dec. 1892		Total	
	£	s d	£	s d	£	s d	£	s d	£	s d	£	s d	£	s d
Grocery Department.. Wines and Spirits Department ..	2,250	0 0	17,750	0 0	2,000	0 0	22,000	0 0	20,000	0 0	2,000	0 0	22,000	0 0
Drapery Department..	20,000	0 0	13,300	0 0	1,500	0 0	35,000	0 0	10,000	0 0	25,000	0 0	35,000	0 0
Tailoring do. ..	7,500	0 0	24,300	0 0	4,000	0 0	46,000	0 0	40,000	0 0	6,000	0 0	46,000	0 0
Mantle do. ..	4,750	0 0	4,625	0 0	525	0 0	10,000	0 0	3,000	0 0	3,000	0 0	10,000	0 0
Fancy Goods do. ..	5,000	0 0	10,375	0 0	2,625	0 0	18,000	0 0	15,000	0 0	3,000	0 0	18,000	0 0
Furniture do. ..	3,500	0 0	3,625	0 0	875	0 0	8,000	0 0	5,000	0 0	3,000	0 0	8,000	0 0
	12,000	0 0	26,500	0 0	2,500	0 0	41,000	0 0	25,000	0 0	16,000	0 0	41,000	0 0
	£55,000	0 0	£110,875	0 0	£14,125	0 0	£180,000	0 0	£120,000	0 0	£60,000	0 0	£180,000	0 0

Grocery Department..
Wines and Spirits
 Department ..
Drapery Department..

Dr. PROFIT AND LOSS ACCOUNT (SECOND SECTION) FOR THE YEAR ENDED 31ST DECEMBER 1892. Cr.									
To Rent, Rates and Taxes .. ..		..	..	..	..	By Gross Profit for the year, as per Trading Account .. ..		..	..
" Salaries of Assistants, &c., viz.:—		..	..	£4,000	0	0	..	..	..
Salaries .. ..		..	..	2,500	0	0	..	..	..
Cost of Board .. ..		..	..	..	..	..	..	..	..
" Trade Expenses .. ..		..	..	..	..	..	..	..	..
" Carriage.. ..		..	..	..	..	..	..	..	..
" Depreciation .. ..		..	..	..	..	..	..	..	..
" Balance carried down .. ..		..	..	..	..	..	..	..	..
						11,250	0	0	
						2,875	0	0	
						£14,125	0	0	
									£14,125 0 0
(THIRD SECTION.)									
To Interest on Capital .. ..		..	..	..	..	By Balance brought down .. ..		..	..
" Income Tax .. ..		..	..	..	..	" Discounts upon Purchases* .. ..		..	..
" Balance, being net profit for the year, viz.:—		..	..	..	..
A., one-half share .. ..		..	..	..	..
B., one-third share .. ..		..	..	..	..
C., one-sixth share .. ..		..	..	..	..
						2,625	0	0	
						1,287	10	0	
						858	6	8	
						429	3	4	
						2,575	0	0	
						£5,200	0	0	
									£5,200 0 0

* Discounts upon Sales (if any) should be shown separately, on the debit side of the third section of this account.

MANUFACTURERS' ACCOUNTS.—Passing on to the accounts of manufacturers, it is first necessary to subdivide this heading in accordance with the various classes of business that fall hereunder. There is first of all the class of manufacturers but slightly removed from the trader—that is to say, the manufacturer who does not require to sink a large proportion of his capital in expensive plant and machinery, the most typical examples of which are, perhaps, that of the small manufacturing jeweller and the small manufacturing tailor—both of whom, by the way, are fast dying out. In this class, as with traders pure and simple, the selling price is based upon a percentage of so-called “Gross Profit,” the outlay in this case being the cost of materials together with the wages spent upon manufacturing; and, therefore, although the method is clearly indefensible from a theoretical point of view, the division between the first and second sections may conveniently be drawn exactly where it is drawn by the manufacturer himself in his mental calculations. Those who wish to have their accounts as complete as possible may prefer in addition to make a further subdivision of this account in the second section, separating the expenses of manufacturing (such as rent of factory, wages paid for supervision of workers, depreciation of plant, &c.) from those expenses which relate more particularly to the storing of goods and the selling thereof; but inasmuch as the balance shown by this break would correspond with nothing in the mind of the manufacturer it appears to be superfluous, and it will, probably, be thought sufficient to merely show separate totals for these classes of expenditure in the same section, as shown below:—

[illegible]

The manufacturers belonging to the next class are those whose transactions consist in the manufacture of one or more classes of goods involving expensive plant, which goods are first manufactured and then warehoused before being sold. These undertakings are naturally upon a much larger scale than those which have just been considered, and consequently it will be found that the accounts are, as a rule, more scientifically kept, and the method of costing more complete.

The first section of the account thus becomes divided into two parts upon what may be called parallel lines, viz. :—

The Manufacturing Account, which deals with the conversion of raw material into manufactured articles, and shows the profit upon manufacture and the stock of raw materials on hand.

The Trading Account proper, drawn upon the same lines as the first section of a trader's Profit and Loss Account.

The second and third sections of the account do not present any new features that call for consideration.

The form shown below is thought to be the most suitable one for this class of accounts, but, of course, the precise wording will depend entirely upon the particular industry carried on.

The figures shown are the same figures as those employed in the first section of the account stated above, re-drafted for the purpose of separating the results of manufacturing from those of trading.

CONTRACTORS' ACCOUNTS.—The next class of manufacturers to be dealt with consists of those that may conveniently be summarised under the head of "Contractors," *i.e.*, those manufacturers who only make articles which have already been sold for an agreed price. To this class belong builders and many engineers.

It is, perhaps, more in this class than anywhere else that the absolute necessity of proper Cost Accounts is so evident. Indeed, all contractors' accounts may be regarded as incomplete which do not provide, in addition to an ordinary Profit and Loss Account, a "Summary of Cost Account," showing the same result. This being done, the chief interest centres round the Cost Account rather than the Profit and Loss Account itself, and there is thus less necessity for the latter to be unduly elaborate. It is therefore usually best to state this latter account in two sections only, the first section corresponding to sections 1 and 2 in the classes of accounts that have already been considered, and the second dealing only with the financial items, as shown below.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER 1892.										Cr.	
Dr.											

The Summary of Cost Account may be shown in a tabulated form, the totals of the vertical columns agreeing with the various items of the Profit and Loss Account (but, perhaps, somewhat more summarised in form), while the details of the columns headed "Profit and Loss" would show the actual amount of profit realised or loss incurred over the execution of each separate contract, thus:—

Dr. SUMMARY OF COST ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER 1893. Cr.

Number of Contract	Forward from last Account	Wages		Stores Issued	Materials Purchased	Plant Issued	Special Expenses	General Expenses	Discount and Interest	Net Profit on Contract	Total	Number of Contract	Amount of Contract	Stores returned or sold	Plant returned or sold	Total Loss on Contract	Total Cost of Contract (if uncompleted)	Total
1,285	£ 10,000	Hours of 10	£ 400	£ 500	£ 250	£ ..	£ 10	£ 62	£ 9	£ 650	£ 11,881	1,285	£ 10,000	£ 81	£ 1,800	£ ..	£ ..	£ 11,881
1,286	£ 5,000	50	2,000	1,500	4,750	750	40	312	42	..	14,394	1,286	12,500	194	700	1,000	..	14,394
1,287	£ ..	100	4,100	2,500	7,500	1,250	120	625	83	950	17,128	1,287	16,000	28	1,000	..	..	17,128
&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.	&c.
	£20,000†	1,200	£50,000	£46,000	£72,000	£25,000	£2,500	£7,500	£1,000	£27,500	£251,500		£200,000	£6,000	£22,500	£1,000	£22,000 †	£251,500

† Sundry Debtors .. £16,000
Stores.. .. 2,000
Plant 2,000
£20,000

* Omitting "000's"

‡ Sundry Debtors .. £15,000
Stores.. .. 4,500
Plant 2,500
£22,000

STATISTICAL INFORMATION.—In connection with all the preceding accounts it will usually be found of the very greatest assistance to add statistical columns, for the purpose of showing the relation which each item bears to the amount of trade done. This relation will usually be expressed in the form of a percentage on the amount of the sales, but where the business deals with articles of a uniform or similar character—as, for instance, in the case of collieries, brickyards, and the like—the percentage will probably be based upon some quantity, or unit, of the goods dealt in, as “per ton of coal” or “per thousand bricks,” and in these cases it is usually thought more convenient for the unit to be the production rather than the sale.

In published accounts it is also somewhat usual, and very convenient, to publish, side by side with the figures for the current period, those for the next preceding period, for the purposes of comparison. For the sake of clearness these are best placed on the left-hand side of the description of the various items, and in italics, or some other type which may be readily distinguished from that in which the accounts for the current year are printed.

MINING ACCOUNTS.—Another very important class of accounts, which can hardly be said to come under any of the previous headings, are those relating to mines. These accounts are best dealt with in a manner somewhat similar to that indicated in the case of contractors; that is to say, in one section include all the items relating to the actual working of the undertaking, and in the second section those appertaining more particularly to finance. Cost Accounts would be made weekly or monthly, but they would usually form no part of the annual accounts.

NON-COMMERCIAL ACCOUNTS.—With regard to Non-Commercial Accounts, the system of dividing the account into two sections only conveniently applies. It may be added that the introduction of a separate section for the financial items possesses this further advantage, that, in those cases

where it is deemed inadvisable to publish full accounts, the published account may conveniently consist of the last section of the Profit and Loss Account only. Of course, this consideration will only apply in the case of the accounts issued by a company to its shareholders; and, in such cases, when only the final section of the Profit and Loss Account is published, it should contain not only the directors' fees, interest on debentures, contributions towards reserve fund, &c., but also the amount set aside for depreciation of plant, investments, &c.

2.
— **"NET PROFIT."**—This is, perhaps, the proper place to offer a protest against the method adopted by many companies of stating in their published accounts a so-called "Net Profit," out of which it is proposed to set aside a certain sum for depreciation and directors' fees. Of course, if the articles of association provide that the accounts shall be so stated, there is, for the moment, no other course to be adopted, but it is suggested that too early an opportunity cannot be taken of altering articles which produce so clearly misleading a result.

STATUTORY FORMS OF ACCOUNT.—The foregoing remarks do not, of course, relate to those undertakings whose form of accounts is specially provided for by Act of Parliament. These are:—

The accounts of such railways and tramways as come under the provisions of the Regulation of Railways Act 1868.

The accounts of such gas companies as come under the provisions of the Gas Works Clauses Act 1871.

The accounts of life assurance companies, which come under the provisions of the Life Assurance Companies Act 1870.

And a few other undertakings (such as building and friendly societies), to which many of the points now being raised do not apply, or apply only in a modified form.

Inasmuch, however, as the form of accounts provided in each of these cases is probably as excellent a one as could well be

conceived (due exception being always taken to the transposed form of Revenue Account provided for life assurance offices), it is clearly advisable to adopt it whenever appropriate, even in such cases as it is not absolutely compulsory, and this also applies (to a certain extent, at all events) to the accounts of water companies, which possess many features in common with those of gas companies, although, strangely enough, there is no statutory form for the accounts of such undertakings.

It is not a little curious that many gas *and* water companies are constituted under the provisions of the Gas Works Clauses Act 1871, and this occasionally without expressly requiring them to keep separate accounts for gas and water. In such cases it will usually be found quite impossible to do more than provide separate Revenue and Capital Expenditure Accounts for "Gas" and "Water," but in such a case the statutory form of accounts will, of course, be followed as nearly as possible.

BALANCE SHEETS.—Turning now to the question of Balance Sheets, perhaps the first point to be disposed of is the rival advantages of the Single and Double Account systems.

SINGLE AND DOUBLE ACCOUNT SYSTEMS.—In undertakings whose accounts are based upon the latter system it is assumed that the capital of the undertaking has been sunk in the purchase and construction of definite permanent works, and the Balance Sheet is divided into two portions, one showing, on the one hand, the expenditure on such works, and upon the other the capital raised wherewith to meet such expenditure, while the second section, or "General Balance Sheet," contains what may be conveniently called the "floating" assets and liabilities arising incidentally in the course of carrying on the undertaking. It has been thought by some that this method of stating the accounts absolved the company from making any provision to meet depreciation of its permanent assets, and to a certain extent (*e.g.*, with regard to preliminary expenses) this would appear to have been the intention of the Legislature; but what was really intended seems to have been that fluctuation, rather than depreciation, was to be disregarded; and it is,

perhaps, well to call attention to the fact that it is not only possible but also perfectly easy for provision for depreciation to be made and stated in accounts kept upon the Double Account system.

WHAT ARE ASSETS?—Going back to first principles, it must be admitted that an asset may be fairly defined as “an expenditure upon a remunerative object,” and, indeed, it may be taken as the test of whether any particular expenditure is an asset or a loss, to inquire whether as a matter of fact such expenditure was—looking back at it—worth the amount expended upon it. This applies whether the expenditure is in the nature of capital spent in the purchase or construction of any particular property, or in the purchase of property or labour which was subsequently sold to another. In the former case, if—looking back upon it—it is considered that if the opportunity of making the investment a second time should again arise it might reasonably be made upon the same terms, it may fairly be said that there is value for the original outlay; and in the latter case, if—looking back upon it in the light of present experience—one would again sell upon trust to any particular individual property upon which time or money had been expended, it may fairly be said that value is still remaining for the amount with which it at present stands charged. If, on the other hand, it appears that the value remaining for such expenditure is less than the original amount of such expenditure, it is obvious that, as a matter of fact, depreciation has occurred.

NECESSITY FOR DEPRECIATION.—With regard to those few classes of undertakings whose accounts the law requires to be kept upon the Double Account system, it would appear that (in view of the permanence of the undertaking and the subsequent remoteness of realisation and an *ascertained* loss) the Legislature does not require any provision to be made to meet such depreciation, except in the case of leaseholds; but, on the other hand, it indirectly sanctions (where it does not expressly enforce) the provision of a prudent reserve to meet any outlay that may in future be required to keep the property

in a state of working efficiency equal to that in which it at first stood. On the other hand, it is a very generally accepted principle with regard to those undertakings which are not specially provided for by the Legislature, that before reckoning profits an adequate sum should be set aside to meet any loss arising from the depreciation of property. Curiously enough, however, it would appear doubtful as to whether the law compelled any company to make provision for depreciation before declaring dividends out of its earnings.

In both cases, therefore, the question of depreciation is rather one of prudence, or of internal administration, than of compulsion; and, moreover, it will be seen that there is no essential difference in this respect between accounts kept upon the Single Account system and those kept upon the Double Account system. In both cases, it is usual to provide for depreciation, although the method employed under the two systems naturally varies.

METHOD OF PROVIDING DEPRECIATION.—Upon the Double Account system, it being impossible to deduct the depreciation from the amount shown in the Capital Expenditure Account, the method adopted is to accumulate the amount set aside from time to time upon a Depreciation (Fund) Account, or a Repairs (Fund) Account, which is included as a liability in the General Balance Sheet (although not necessarily stated separately). On the other hand, the more usual course to adopt with accounts kept upon the Single Account system is to deduct the amount written off for depreciation from the amount at which the value of the asset is stated, and this whether the Assets Account and Depreciation Account are kept separate in the Ledger or not.

CHOICE BETWEEN DOUBLE AND SINGLE ACCOUNT SYSTEMS.—It will therefore be seen that the question as to whether a certain set of accounts should be kept upon the Double or the Single Account system, however interesting it may be in other respects, does not really in the least affect the question of the desirability or necessity of making an adequate provision for the depreciation of wasting

assets. There is this, however, to be said—that while, with accounts stated upon the Double Account system, it will naturally be assumed (in the absence of evidence to the contrary) that no such provision has been made, it will in the case of accounts kept upon the Single Account system be as naturally supposed that the values assigned to the various assets are actual, and not fictitious, amounts. Consequently in those undertakings where it is difficult, if not impossible, to assign an accurate value to a company's assets (and where those assets are of a permanent nature and represent the bulk of the working capital), the Double Account system may advantageously be adopted, as being the less likely to create a misapprehension upon the part of the shareholders. For example, in the case of a single-ship company it is usual to make no allowance for depreciation of the value of the vessel, which naturally represents practically the whole of the company's capital. Such a case is particularly suitable for the Double Account system, and that for the simple reason that this system best records the actual facts of the case, which are as follows:—

A certain number of persons, having collectively subscribed a certain sum, purchased therewith a ship, with which they proceeded to earn profits to be distributed among them. Upon the Double Account system the distinction between these two points is very clearly defined: In the Capital Account is shown the amount subscribed by the shareholders on the one side, and upon the other the cost of the vessel together with the balance of working capital (if there be any); while in the General Balance Sheet are shown only the floating assets and liabilities. Under these circumstances, no shareholder who possessed any knowledge of accounts could reasonably complain if, in the event of the vessel being sold at a subsequent date, it should be found to have deteriorated in value; for he would know that the question of depreciation had never been considered, and that throughout the career of the company the net proceeds of each voyage have been divided among the shareholders.

On the other hand, with companies who venture the bulk of their capital in any ordinary trade, the question is widely

different ; for in such cases the permanent assets naturally form a much smaller proportion of the total capital, and consequently the Double Account system (which pre-supposes the investment of practically the whole capital of the undertaking in permanent assets with which the business of the company is carried on) does not apply ; and in these cases, therefore, it is essential that all assets which are not taken into account at what may fairly be assumed to be their value at the date of the accounts should be definitely stated to be " at cost."

The various items which are ordinarily found upon a Balance Sheet will now be dealt with in order, and the best form of wording under various circumstances considered. For this purpose the best course will be to take as a model the form of Balance Sheet provided in " Table A " of the Companies Act 1862, which sets the liabilities upon the left-hand side and the assets upon the right-hand side, commencing upon both sides with the most permanent items and leaving those which are most constantly varying to the last.

FORM OF BALANCE SHEET.—Some years ago it was not unusual to find Balance Sheets stated with the assets upon the left-hand and the liabilities upon the right-hand side. The circumstance is, doubtless, at first sight curious, but, like many other things, there was good reason underlying this apparent anomaly. Under the Italian system of bookkeeping, which is still practised in some old-fashioned merchants' houses, it is the custom at every period of balancing, after the Nominal Accounts have been closed, to transfer the balances of the Real and Personal Accounts into one account, usually called in England the " Balance Account," and in France the "*Balance de Sortir*," or " Closing Balance." Under such circumstances, the Ledger would be actually closed (which, in fact, is never the case under the ordinary English system), and the Balance Account so raised would practically be a detailed Balance Sheet, but with the assets upon the *Dr.* and the liabilities upon the *Cr.* side, as shown in the old-fashioned Balance Sheets already referred to. The re-opening of the Ledger for the next period's transactions would necessitate the *writing back* of

the balances of the Real and Personal Accounts to their respective headings ; which would involve (for the sake of completing the Double Entry) a second Balance Sheet, but with the sides transposed, viz., the liabilities upon the *Dr.* and the assets upon the *Cr.* side. Why this latter, rather than the former, should be the form which is now generally adopted it is not very easy to see ; but, perhaps, the best reason that can be given is that insomuch as a set of books must be formally opened before they can be closed, the first Balance Sheet will naturally be in the form of an Opening Balance Sheet in the modern form ; and that, consequently, where the abbreviated methods of modern bookkeeping dispensed with the actual closing of the books at each balancing, it would be natural to adhere to the form of Balance Sheet which was used in the first instance. Inasmuch, however, as our modern Balance Sheet is not a Ledger Account, but merely a summarised extract from the Ledger, many accountants consider that the headings "*Dr.*" and "*Cr.*", "*To*" and "*By*," are out of date, and do not, therefore, employ them in Balance Sheets. The author is aware that this view has been attacked by Mr. ERNEST COOPER, F.C.A., but it is one so generally received that it does not appear desirable to devote further space to a matter of such slight importance.

CAPITAL.—Upon the liability side of a Balance Sheet the most prominent item—in the case of a limited company at least—is the shareholders' capital, which, of course, can only be increased beyond its original limit, or reduced, after due compliance with important legal technicalities. In stating the Capital Account, it is desirable to show, first, the nominal capital, *i.e.*, the limit sanctioned by the memorandum of association ; secondly, the number and value of each class of shares issued and the amount called up thereon, from which should be deducted the amount of calls in arrear, stating the number of shares upon which such calls are due. In France, and also in South America, it is usual to state the full amount of the capital issued as a liability, and the amount uncalled as an asset ; but this is not at all a desirable form to adopt, as it can hardly be said that uncalled capital is more than a contingent asset.

The next item to be stated is the amount paid up upon shares forfeited, when such shares have not been re-issued by the company. When they are re-issued this item may appropriately be absorbed in the Reserve Fund.

DEBENTURES.—Next comes the amount due upon debentures, the amount extended being the nominal amount; or, in the case of debentures issued at a discount, the amount actually received. In the latter case, however, the nominal amount should also be stated, and in both cases the rate of interest should be mentioned. The appropriate place for premiums received upon issues of either shares or debentures is in the Reserve Fund.

MORTGAGES.—The next item upon the Balance Sheet will be the amount due upon mortgage, which, like most debentures, constitutes a preferential liability, and ordinarily speaking is practically permanent. The rate of interest should be stated here also.

OTHER LIABILITIES.—Next come the ordinary liabilities of the company, which, according to "Table A," are separated under the following sub-headings:—

- (a) Debts for which acceptances have been given.
- (b) Debts to tradesmen for supplies of stock-in-trade and other articles.
- (c) Debts for law expenses.
- (d) Debts for interest upon debentures and other loans.
- (e) Unclaimed dividends.
- (f) Debts not enumerated above.

It has become a very general practice for the item "(d) Debts for interest upon debentures and other loans" to be shown as an addition to the loans themselves. There is, of course, no possible objection to this proceeding from an accountant's point of view; and, indeed, this seems to be the proper place for it.

RESERVE FUNDS.—The next item upon the liability side is for “Reserve Fund, showing the amount set aside from profits to meet contingencies.” This, perhaps, is as good a definition of a Reserve Fund as has been offered, and although special Reserve Funds may be created for the purpose of providing for special contingencies, it may be taken as an axiom that no sum which is not set aside *from profits* can properly be called a Reserve Fund. Nevertheless, under the heading of “Reserve” all sorts of items are frequently included which under no possible circumstances can be considered to have been set aside out of the profits. This, perhaps, raises the somewhat large question as to what *are* actual profits, but it must at least be admitted that the term “Reserve Fund” is by no means applicable to all the following:—

(a) A sum set aside to meet depreciation of property, and to provide for its future renewal. This is a charge against profits, rather than a sum set aside out of profits.

(b) A sum set aside for the purpose of equalising the charge against Profit and Loss for repairs and replacement of machinery, &c. This, also, would appear to be a charge against profits.

(c) A reserve to provide for loss upon bad debts or depreciation of investments would likewise appear to be a charge against profits, unless, indeed, the amount so set aside was more ample than the circumstances of the case necessitated; and in this case it would probably be a better course to charge against profits what might be considered a fair reserve for loss, and to accumulate any further reserve that might be thought prudent in the form of a Reserve Fund pure and simple.

(d) Investment Fluctuation Account. This is an item which, unless further explained, should never appear upon the face of a Balance Sheet, and that for the simple reason that its meaning is by no means clear. It may mean that investments have been re-valued at a higher figure than cost price, and the proceeds carried to this account rather than credited to Profit and Loss or to Reserve Fund; or, on the

other hand, it may mean that the investments are stated in the Balance Sheet at a higher figure than their actual value, and that the amount of the Investment Fluctuation Account is an amount set aside in anticipation of future loss. The former is a perfectly legitimate form of special Reserve Fund; the proper place for the latter (which is, in fact, merely a Depreciation Account) appears to be in reduction of the stated value of the assets.

(e) Sinking Fund, or an amount set aside (and specifically invested) for the purpose of meeting a future loss upon redemption of debentures issued at a discount, renewal of leases, &c.

(f) The so-called "Reserve Fund" of a life assurance company, which really amounts to a fund set aside out of the surplus premiums paid by the assured in the earlier years of their insurance to meet the deficiency of such premiums to cover the increased risk of later years, when the expectation of life is shorter. To a very large extent the Reserve Funds of life assurance companies are "premiums paid in advance," rather than "accumulated profits."

There can be no doubt but that it is improper to state as a Reserve Fund any sum which has not been actually set aside out of profits, not for the sake of meeting an anticipated future loss, but rather solely for the purpose of providing against unforeseen contingencies.

THE INVESTMENT OF RESERVE FUNDS.—So much has been written upon the "fictitious" nature of all Reserve Funds that are not actually invested in securities outside the business itself that it seems desirable, in a work of this character, to examine the arguments that have been raised in support of this contention. So far back as 1890, Mr. T. A. WELTON, F.C.A., expressed his views upon this subject in the following terms: "The expediency, or otherwise, of making special investments of reserved profits can only be determined after a careful review of the circumstances in each particular case. I lay the more stress upon this matter because it has

become the fashion in some quarters to urge that all reserves, including those of banking companies, should be specially invested, without any regard to the nature of the prospective requirements to meet which they are provided." It is believed that at that time the soundness of such views was not really seriously disputed by any very considerable section of either the Press or the public; but the numerous failures that occurred during the years 1892 and 1893 showed that the mere existence of a large Reserve Fund did not in itself suffice to ward off disaster, and hence (being in somewhat of an unreasoning mood) many unfortunate shareholders hastened to express the view that these "paper reserves" were "fictitious." Most of the lay Press took up the cry, and their arguments—which it must be admitted were somewhat plausible—have now sunk so deeply into the public mind that it is not unlikely that the misconception will prove ineradicable.

In the interests of truth, however, the attempt must be made to prove the absurdity of such conclusions. Much has already been done in this direction by *The Accountant* newspaper, and it is thought that the following article, which is reprinted from *The Accountant* of the 25th August 1894, will be found to well state the "case for the defence":—

The recent correspondence in *The Times*, which we have reproduced in our last two or three issues, has raised few new points in this much discussed controversy; but several of the old misconceptions have been more than usually clearly stated, and it thus again becomes desirable that their fallacy should be emphasised with an equal distinctness.

The points at issue practically resolve themselves into—

- (1) A disagreement as to the applicability of the term "Reserve" to undivided profits, no matter what the form in which they are held (or reserved); and
- (2) A confusion as to the relations subsisting between such reserved profits and certain investments purporting to represent the same.

Dealing first of all with the applicability of the term "Reserve" to all *bond fide* profits that are reserved (*i.e.*, not distributed), it would be idle to ignore the fact that the general public appear to have attached a special meaning to the term "Reserve," which is decidedly narrower than that employed by accountants. The latter are practi-

cally unanimous in the opinion that all *bond fide* profits not distributed are in the nature of reserve, and this, whether they have been permanently capitalised or merely temporarily reserved—*i.e.*, not distributed. It has been rightly pointed out by Mr. WELTON (in the course of the discussion we are now considering) that such undivided profits cannot by any known process be placed out of the reach of the ordinary risks of fluctuation and loss that are inseparable from commerce; the continued existence of undivided profits must—whether such profits be separately invested or no—be contingent upon the maintenance of the excess of assets over liabilities. These undivided profits, then, inevitably vary or fluctuate from day to day—from hour to hour even—and their very existence must always be “subject to realisation” of the company’s assets. A fall in values may at any time wipe out a company’s “Reserve,” even though such reserve is supposed to be represented by a specific investment that has suffered no shrinkage.

This is the question that the general public seems to be incapable of adequately appreciating. Having arbitrarily settled in its own mind to call nothing a Reserve that is not specifically invested in gilt-edged securities, the public proceeds to confuse the investment with the actual Reserve itself; and because the investment is practically beyond risk of loss or serious fluctuation, to assume that the continued existence of the Reserve itself is therefore assured. This is a misapprehension that requires to be corrected. Whether we employ the term “Reserve” to describe undistributed profits or not, the continued existence of such undistributed profits depends upon the maintenance of the stated values of the various assets and upon their eventual realisation at such stated values. If the “Reserve” be invested in first-class securities, the risk of shrinkage in value is lessened to the extent that first-class securities are, generally speaking, a less speculative form of investment than the assets ordinarily held by a trading company; but only in so far as the investment of a Reserve improves the average character of the company’s assets does it possess any advantage whatever over the employment of undivided profits in the company’s business. The only possible means by which a company can free itself from all risk of loss in respect to undivided profits is to divide them among the shareholders, and so shift the risk from its own shoulders on to each individual shareholder’s. The fact that this division of profits up to the hilt is universally regarded as a weakening of a company’s position ought to be sufficient to show that undivided profits—no matter how employed—are an undeniable source of financial strength.

Let us now take a few concrete examples for the purpose of emphasising the position we have taken up. Suppose the position of a company to be truly recorded by the following Balance Sheet:—

BALANCE SHEET, 31ST DECEMBER 1893.

Liabilities				£	Assets				£
Capital ..	..	..	..	100,000	Buildings, &c.	..	..	..	50,000
Creditors ..	..	..	..	40,000	Stock ..	..	..	..	50,000
Profit and Loss ..	..	..	..	50,000	Book Debts ..	..	..	..	40,000
					Cash ..	..	..	..	50,000
				<u>£190,000</u>					<u>£190,000</u>

Now, assuming that the figures attached to the various assets are *bond fide* values upon the basis of a going concern, the company shows a profit of £50,000, which may be employed

- (1) In payment of a dividend of 50 per cent., or
- (2) In payment of a dividend at the rate of, say, 10 per cent., the balance being reserved.

If the former course be adopted the Balance Sheet assumes the following form:—

BALANCE SHEET, 31ST DECEMBER 1893.

Liabilities				£	Assets				£
Capital ..	..	..	..	100,000	Buildings, &c.	..	..	..	50,000
Creditors ..	..	..	..	40,000	Stock ..	..	..	..	50,000
					Book Debts ..	..	..	..	40,000
				<u>£140,000</u>					<u>£140,000</u>

If the latter course be adopted the Balance Sheet would be usually stated in the following form:—

BALANCE SHEET, 31ST DECEMBER 1893.

Liabilities				£	Assets				£
Capital ..	..	..	..	100,000	Buildings, &c...	..	..	..	50,000
Reserve ..	..	..	..	40,000	Stock ..	..	..	..	50,000
Creditors ..	..	..	..	40,000	Book Debts ..	..	..	..	40,000
					Cash ..	..	..	..	40,000
				<u>£180,000</u>					<u>£180,000</u>

We take it that *The Times* would object to the above Balance Sheet as misleading, but would sanction the use of the term “Reserve” if the Balance Sheet appeared as follows:—

BALANCE SHEET, 31ST DECEMBER 1893.

Liabilities				£	Assets				£
Capital ..	..	..	..	100,000	Buildings, &c...	..	..	..	50,000
Reserve ..	..	..	..	40,000	Stock ..	..	..	..	50,000
Creditors ..	..	..	..	40,000	Book Debts ..	..	..	..	40,000
					Investment of Reserves ..	..	..	..	40,000
				<u>£180,000</u>					<u>£180,000</u>

To the unbiassed observer, however, it must be obvious that the distinction is an arbitrary one, for £40,000 at the bank (if the bank be a good one) is practically as safe as £40,000 in Consols, while in each case the maintenance of the Reserve depends not merely upon the maintenance of the bank balance in the one case and of the investment in the other, but upon the maintenance of the surplus of the assets over liabilities, and upon that alone. It is our contention that the Reserve would be every bit as real if the bank balance, instead of being invested, was employed in paying off the creditors, when the Balance Sheet would appear as follows:—

BALANCE SHEET, 31ST DECEMBER 1893.

<i>Liabilities</i>					<i>Assets</i>				
				£					£
Capital ..	..	..	..	100,000	Buildings, &c. ..	..	..	50,000	
Reserve ..	..	..	..	40,000	Stock ..	..	..	50,000	
					Book Debts ..	..	..	40,000	
				<u>£140,000</u>				<u>£140,000</u>	

Here the maintenance of the Reserve (as before) depends upon the continued maintenance of the value of the various assets, but the risk of shrinkage is reduced because one element of risk (the failure of the bank, or a fall in Consols, as the case may be) has been eliminated.

Personally, we cannot understand how the term "Reserve" used in this connection can possibly mislead anyone, for the actual assets are stated, and so anyone may readily see for himself whether any investment exists or not. Still, it is obvious that there is a very serious misconception upon the part of the public, or the discussion that has recently appeared upon the subject would not have arisen. Under these circumstances it is, perhaps, a matter worthy of consideration whether the term "Reserve" should not be discarded altogether, and the term "Surplus" or "Rest" employed to designate capitalised profits, whether specifically invested or employed in the business. It remains to be noted, however, that the real cause for complaint is not as to the manner in which a *bond fide* Reserve is employed, but should be directed against a most undesirable custom that obtains in some quarters of unjustifiably inflating the so-called "Reserve" by upholding depreciating or depreciated assets at a fictitious value.

Much space has been devoted to this subject on account of the prevalence of misconception in connection therewith, but on the other hand it must be remembered that in many cases it may be extremely *desirable* that a company should hold

investments equivalent to the amount of its Reserve Fund. As has already been stated, however, the matter is one entirely within the discretion of the directors, and is not one upon which the Auditor need feel called upon to express an opinion.

UNDIVIDED PROFITS.—The last item upon this side of the Balance Sheet is the balance of undivided profit. It is preferable to show this balance without elaboration upon the Balance Sheet and in a "Profit and Loss Apportionment Account" (or the last section of the Profit and Loss Account) to show the connection between the balance shown upon the Balance Sheet and the balance of the Profit and Loss Account for the current period. There is, however, no more serious objection to showing the details upon the Balance Sheet except that it does not appear to present the facts of the case so clearly.

CONTINGENT LIABILITIES.—With the question of Contingent Liabilities it is not necessary to deal at length, beyond stating that all such liabilities must be noted upon the Balance Sheet, even if it is anticipated that they will not ultimately result in a claim against the company.

THE ASSETS SIDE.—Turning now to the assets, it is convenient to deal with these—as with the liabilities—under their various heads.

FIXED ASSETS.—"Table A" deals first with "Freehold Land," "Leasehold Land," and "Leasehold Buildings," which it requires to be stated separately, and apparently without deduction for depreciation. The word "apparently" is used advisedly, for depreciation is not here mentioned, although it is specifically provided for in the case of "Stock-in-trade" and "Plant." This tends to show that, even in accounts stated upon the Single Account system, the Legislature did not intend to make it compulsory for the permanent assets of a company to be re-valued periodically; and this, it will be remembered, is a question with two sides to it, viz., the possibility of a rise in value, and the possibility of a fall. Had leaseholds been excepted, it might reasonably be assumed that it was intended

that companies should not allow either a rise or fall in their permanent assets to modify their trading profits ; but it is impossible to suppose that the depreciation of leaseholds was intended to be ignored, and therefore the whole point remains (as it must remain until the question is definitely settled by a further enactment) extremely uncertain, so far as the legal obligations of a company are concerned, although there need be no uncertainty as to what is the most prudent course to adopt.

FLOATING ASSETS.—Next in order “Table A” states Stock-in-trade and Plant, “the cost to be stated, with deductions for deterioration in value as charged to Reserve Fund or Profit and Loss.” It would have seemed more natural to have placed Plant before Stock-in-trade, as being, properly speaking, a “fixed asset,” and it seems strange to talk of a “deduction for deterioration in value, as charged to the Reserve Fund.” Inasmuch as the Reserve Fund has already been defined as “an amount set aside from profits to meet contingencies” the deductions that may properly be charged against Reserve Fund would appear to be limited to unforeseen deterioration, rather than for regular depreciation.

Next come “Debts owing to the company,” which for some inexplicable reason appear to be stated under separate headings, instead of being under sub-headings, as in the case of the debts owing by the company. The headings are as follows :—

Debts considered good, for which the company holds bills or other securities.

Debts considered good, for which the company holds no security.

Debts considered doubtful and bad.

It is also provided that “any debt due from a director or any other officer of the company is to be separately stated.”

It is not usually considered desirable to separately state the amount of the doubtful and bad debts, but the provision for the separate statement of any debt due from a director or other officer is one that should not be lost sight of ; doubtless, it is

not intended to apply in the case of debts for small amounts in the regular course of business, but cases will readily occur to the reader in connection with some recent failures where the compliance with this provision might have materially affected the course of events.

The next item on the Balance Sheet is Investments, which should be stated in some detail, and if the investments are on account of Reserve Fund or Sinking Fund the circumstance should be clearly stated. The Life Assurance Companies Act 1870 provides the following subdivision of the item Investments upon the Balance Sheets of Life Assurance Companies, and the example is worth following under all ordinary circumstances:—

British Government Securities.

Indian and Colonial Securities.

Foreign Government Securities.

Railway and other Debentures and Debenture Stocks.

Railway Shares (Preference and Ordinary).

House Property.

Other Investments (to be specified).

It would, however, seem desirable in many cases to state the actual investments separately, for when it is remembered that such an item as "Foreign Government Securities" may include investments so various as French Rentes, Turkish bonds, and South American Republic bonds, it is obvious, in this case at least, the particular heading adopted is no indication whatever to the general desirability of the investment. Again, "Railway Shares" may mean anything between Great Western Stock and Grand Trunk Stock, to say nothing of Mexican and other similar railways.

Last upon the Assets' side is the item of Cash, which is best separated into—

Amount at Bankers on Deposit, including accrued interest.

Amount upon Current Account, and

Amount in hand.

GENERALLY.—It is hardly necessary to enter in detail into the forms of Balance Sheets required for different classes of undertakings; the same rules will apply in almost all cases, and although modifications of detail will appear desirable in almost each particular case, these naturally must be considered and dealt with according to the particular circumstances that obtain, the general principle in all cases being that the accounts must be not only correct, but also so clear as to render misapprehension impossible, even among those who do not profess to be skilled accountants. In this respect it is, perhaps, well to bear in mind the particular classes of persons who are likely to be interested in the accounts. Thus, in the case of a friendly society, lucidity will be the great thing to be aimed at; while in the case of such an institution as a bank the main object of the Balance Sheet is, perhaps, less to inform shareholders as to the amount of their profits than to allow the public to form a reliable estimate upon the bank's stability.

The following three general forms of Balance Sheets are designed for use under different circumstances :—

PRO FORMA BALANCE SHEET OF A TRADING FIRM.

BALANCE SHEET, 31ST DECEMBER 1892.

Liabilities.		£	s	d	Assets.		£	s	d
Capital Account, viz. :—					Freehold and Leasehold Premises		8,700	0	0
A., Balance 1 Jan. 1892	..	£25,000	0	0	Less Depreciation		150	0	0
Interest thereon..	..	1,218	15	0	Fixtures and Fittings: Value 1st Jan. 1892		1,500	0	0
		26,218	15	0	Additions during the year		450	0	0
Share of year's profits..	£1,287	10	0		Less Depreciation		1,950	0	0
Less Drawings ..	1,000	0	0				100	0	0
		287	10	0	Stock-in-Trade (at cost)		1,850	0	0
B., Balance 1 Jan. 1892	..	15,000	0	0	Cash: At Bank		60,000	0	0
Interest thereon..	..	731	5	0	In hand..		3,975	0	0
		15,731	5	0			425	0	0
Share of year's profits..	858	6	8				4,400	0	0
Less Drawings ..	750	0	0						
		108	6	8					
C., Balance 1 Jan. 1892	..	10,000	0	0					
Interest thereon	..	487	10	0					
		10,487	10	0					
Share of year's profits..	429	3	4						
Less Drawings ..	500	0	0						
		70	16	8					
Trade Creditors	..	..	..	..	
Sundry Creditors	..	..	..	..	
Customers' Deposit Accounts	..	..	..	..	
		10,416	13	4					
		52,762	10	0					
		20,000	0	0					
		750	0	0					
		1,287	10	0					
		£ 74,800	0	0					

CONCLUSION.—In considering these matters, however, it must be borne in mind that it is very exceptional for the form in which accounts are stated to be actually under the control of the Auditor. As a rule, articles of association provide that the accounts shall be rendered in such form as the directors shall think fit, and in such cases it is, of course, impossible for the Auditor to dictate as to the precise form to be adopted. This, however, does not release him from the responsibility of judging as to the fitness of the form in which the accounts are rendered by the directors. In this respect he is placed in a position and furnished with information which is withheld from the general body of the shareholders, for the express purpose of satisfying himself that the accounts submitted by the directors to the shareholders are such as will reasonably disclose the position of the company. Considerations with regard to the form which the accounts should take are frequently of a nature which the Auditor must of necessity weigh for himself; for, inasmuch as the shareholders have no knowledge of the transactions or position of the company other than that which they gain from a perusal of the directors' accounts and the Auditor's report, it stands to reason that if the accounts do not sufficiently disclose these things it may frequently happen that the shareholders themselves would have no reason to suspect that the accounts were not all that they should be. It therefore follows that, although the Auditor does not have the drafting of a company's accounts, it is necessary for him in all cases to consider the form in which they are submitted for his approval, and not merely to content himself with an examination of their technical correctness. It has been stated that the accounts submitted to the shareholders, being the accounts of the directors, they, and they only, are responsible to the shareholders for the form. This is true to the extent that the Auditor has no power to compel the directors to modify the form of their accounts, but it is not true in the sense that if the accounts submitted are, so far as they go, correct, the Auditor is under no responsibility to specially report in such cases as they are insufficient to enable anyone examining them to obtain a correct idea of the com-

pany's position. Were this the case it would indeed be difficult to see in what respect the shareholders gained by an audit of their accounts, for it is obvious that it would be possible to conceal almost anything in the shape of fraud or unjustifiable extravagance. The shareholders have, however, a clear right to such accounts as will enable them from time to time to judge of the value of their investment; and it is for the purpose of making the accounts reliable for this purpose that an Auditor is appointed; and while there rests with him the serious responsibility of concealing such matters of internal detail as would, if divulged, tend to damage the position of the business, yet, on the other hand, he must not fail to remember that it is the shareholders, and not the directors, who are the masters of the fortune of the company, and that (except in matters of internal detail) they have an indisputable right to the fullest and clearest information.

CHAPTER VIII.

WHAT ARE PROFITS?

IN the preceding chapters most of the points arising in the course of an audit, with a view to ascertaining that all due precautions have been taken to test the accuracy of accounts before certifying them, have been considered in some detail; but it is advisable to review some of these various questions from the point of view of considering whether or not the amount of profit stated upon the face of the accounts is actually available for dividend. It is most important to remember in this connection, however, that until an undertaking has been actually wound up, any statement as to the profits earned is merely an estimate, or a statement of opinion and not a question of fact.

ADVANTAGES OF DOUBLE ENTRY.—The reader will hardly require to be reminded that, in the case of an ordinary undertaking, the amount of profit available for distribution will be represented on the Balance Sheet by the excess of the assets there disclosed over the liabilities and capital of the undertaking. But it is desirable for the Auditor, in order to make sure of his position, to look at the matter not merely from a Balance Sheet point of view, but, in the first place, to carefully scrutinise the Profit and Loss Account in order to see that no sources of income have been taken credit for unduly, and that all reasonable expenses have been properly debited, and then to compare the profit shown by such Profit and Loss Account with the surplus before mentioned, stated to be available on the face of the Balance Sheet, after scrutinising all the

assets and liabilities there disclosed. By this means he will have the advantage of looking at the matter from two points of view, which, in so difficult a question as the assessment of actual profits, is of the utmost value.

CAPITAL v. REVENUE.—It will be seen from what has been said above that, at all events economically speaking, no profits are available until provision has been made for keeping the whole of the paid-up capital of the undertaking intact. The absolute necessity for this provision has, however, been rendered somewhat doubtful by many decisions which have been given in the Courts from time to time. Foremost among these may be named the following:—*Lee v. The Neuchatel Asphalte Company, Lim.*, *Verner v. Commercial and General Trust, Lim.*, *Wilmer v. McNamara & Co., Lim.*, and *The National Bank of Wales v. Cory*; all of which will be found reported in full in Appendix “B” to the present work. It may be stated in this connection, however (although necessarily shortly and incompletely), that the effect of all these decisions was that *under certain circumstances it might not be necessary* for a company, before declaring a dividend out of profits alleged to have been earned, to provide in that year’s accounts for the whole of the loss caused by the depreciation of the whole or a portion of its assets. In the case of *Lee v. The Neuchatel Asphalte Company, Lim.*, it is true that the actual facts disclosed did not place it beyond doubt that the fixed assets of the company were in fact less valuable than when they were taken over in the first instance; but in the three later cases the fact that some depreciation had occurred was undisputed, and although some provision had been made for this depreciation in the two last-named cases, it was not seriously contended that a sufficient sum had been written off to reduce the assets to their then actual value. On the other hand, it is very desirable that no undue importance should be attached to these decisions, for it must be remembered that the first three arose out of a motion upon the part of one or more shareholders to obtain an injunction against the directors of a company, restraining them from declaring a dividend; and that, in the absence of

any evidence that creditors would be defrauded, or the rights of one or more classes of shareholders seriously prejudiced, the Courts would naturally not lightly interfere with the deliberate action of the directors, endorsed by a resolution of the company passed in general meeting, in regard to a matter which would certainly appear to be essentially one of internal administration. The last decision (*in re The National Bank of Wales, Lim.*) arose out of a misfeasance summons. The lines followed by the Court here are by no means so clear, and the matter will therefore be more fully considered later on.

DEFINITION OF "PROFITS."—In connection with the question as to what are profits available for distribution, it is of interest to note the definition given in *Buckley*, which is as follows:—"The profits of an undertaking are the excess of revenue receipts over expenses properly chargeable to Revenue Account. It is impossible to lay down any general rule as to what expenses are chargeable to revenue and what to capital."

It will probably be admitted that this is one of the most diplomatic definitions that have ever been given upon a subject of such vast importance; inasmuch as, in the nature of things, it leaves the inquirer exactly where he started, for it still remains for him to define what receipts are attributable to capital and what to revenue, and what expenses are attributable to capital and what to revenue. Could these questions be definitely answered in each case, it is obvious that the question of what the actual profits has been would be one capable of the most ready solution.

Another dictum—namely, that of Lord Justice LINDLEY in the *Neuchatel* case—is of considerable importance, not because it tends to clear up the difficulties which have been mentioned above, but because it unquestionably adds to them. Lord Justice LINDLEY stated that "It is said that such a course involves payment of dividends out of capital—the answer is that the Acts nowhere prohibit such a payment as is here supposed. The proposition that it is *ultra vires* to pay dividends out of capital is very apt to mislead, and must not be under-

stood in such a way as to prohibit honest tradings. It is not true as an abstract proposition, that no dividends can be properly declared out of moneys arising from the sale of property bought by capital. But it is true that, if the working expenses exceed the current gains, profits cannot be divided, and that if in such a case capital is divided and paid away as dividend the capital is misapplied, and the directors implicated in a misapplication may be compelled to make good the amount misapplied." Were the above to be regarded as a final statement of the law upon the subject, it would appear to follow that there is nothing whatever to prevent a company selling a portion of its undertaking and distributing the purchase-money by way of dividend among its shareholders. This, however, would appear to be, at all events, one of those particular conditions which the Companies Act 1877 was expressly formed to meet, when it provided that, under such circumstances as this, a company might return to its shareholders a portion of their paid-up capital, and reduce its capital accordingly. If such return can be made to shareholders without any reduction of capital, it would seem that the time of the Legislature was wasted; and although it is true that for all practical purposes this Act has proved to be almost a dead letter, yet it is difficult to accept the suggestion that it has added *no* powers which did not previously exist in connection with company finance.

It will, from what has been already stated, be readily appreciated that, under such circumstances as those cited, the question as to whether or not a dividend may be declared without serious risks to directors and auditors is one of no little intricacy; and, that being so, there can, it is thought, be no question but that the Auditor would be well advised in refusing to pass accounts showing such disputed items as profits available for dividend, unless he had ascertained that the directors were fortified by the opinion of some leading counsel upon the subject—if not, indeed, by the directions of the Court.

REVENUE RECEIPTS.—These somewhat exceptional points being thus disposed of, the right conception of the effect

of more ordinary transactions may now be considered. For this purpose it will be convenient to classify the various items appearing upon both sides of a Profit and Loss Account, which in the aggregate show the profit alleged to be available for dividend. Upon the credit side these items may be conveniently classified under the following headings:—

- (a) Profit on transactions completed but not yet received in cash.
- (b) Profit on transactions not completed, whether received in cash or not.
- (c) Profit on transactions completed and received in cash.
- (d) Profit arising from an estimated rise in the value of fixed or floating assets.
- (e) Profit not properly incidental to the nature of the business carried on.

With regard to (a) it is hardly necessary to add to what has been already said in the preceding chapters, but the principles there enunciated may be summarised as follows:—It is necessary to consider

- (1) Whether it may be fairly and reasonably anticipated that the debt will be discharged in due course.
- (2) Whether any allowance or discount is likely to be claimed when the debt is discharged; and
- (3) Whether it is necessary to allow for the loss of interest incidental to the deferred payment of such debt.

The points which arise on (b) have already been very fully considered under the headings of “Uncompleted Contracts,” and “Goods sold for future delivery.” It is, therefore, unnecessary to go further into detail in the present chapter. It may be added, however, that, in the case of financial companies underwriting issues of shares or debentures, it would appear to be clearly improper to take credit as a profit for any commission upon such underwriting in respect of that portion of the issue which had been allotted to—and still remained in the hands of—the company by reason of the subscriptions from the

general public being insufficient. The nature of an underwriting agreement is that, in consideration of a certain commission, the underwriter agrees to take up a certain portion of the issue if the public do not subscribe enough among them to take up the whole amount among themselves. In the event of the public subscriptions being insufficient, therefore, the contract has the effect of the underwriter acquiring a certain portion of the issue at a discount; and that is the view which, it is submitted, the Auditor should take of the transaction. If this view be adopted, it necessarily follows that until such shares or debentures are disposed of they should appear as an asset in the accounts of the underwriter, not at their face-value, but at cost price; that is to say, the underwriting commission should be dealt with, not as a profit, but as a reduction from the actual cost of the shares or debentures, as the case may be.

(d) Although the effect of Mr. Justice ROMER's decision in the case of *Bolton v. The Natal Land and Colonisation Company, Lim.*, would appear to be that a company may take credit for an assumed rise in the value of its floating assets, should it think it expedient so to do, it is thought that accountants, as a body, will be more inclined to take the view that any profit arising in respect of dealing in such assets should only be taken credit for in the period during which such dealing actually occurs. That is to say, that assuming such floating assets have risen in value, the proper time to take credit for the profit is not when the rise may, in point of fact, have occurred, but at the time when such assets are sold. Taking credit for profit arising from an assumed appreciation in the value of fixed assets would appear to be more conveniently dealt with under the following heading.

(e) Article 73 of Table "A" of the Companies Act 1862 provides that "no dividends shall be payable, except out of the profits arising out of the business of the company"—that is to say, arising out of some transactions which come within the "objects" for which the company was formed, as set out in its memorandum of association. Inasmuch, however, as Table "A" is not compulsory, and is in the majority of cases super-

sed by special articles of association, it will be seen that this clause has no bearing, except upon those companies which are either registered without special articles or include in their articles a clause similar to article 73 of Table "A." Leaving upon one side the most usual source of profit of this description—viz., the sale of a portion of the company's undertaking—which has already been dealt with, the most ordinary classes of profits to come under this heading would be premiums received upon shares or debentures, and cash which has been paid up upon shares forfeited. The usual custom with both these sources of profits is to credit the amount to Reserve Fund, and it would be difficult to improve upon this. But, at the same time, it may be pointed out that—in the absence of special articles, and in the absence of an article specially so providing—there is nothing to prevent a company transferring the whole, or a portion, of its Reserve Fund to Profit and Loss Account, and to declaring a dividend out of the increased balance so available. However, if this course be adopted, the attention of the shareholders is prominently drawn to the circumstances; and, if that be done, it seems quite clear that the Auditor would be in no way further responsible. As has already been indicated, however, in cases of doubt he would be well advised to draw attention to the exact position of affairs, with a view to escaping any risk of liability.

REVENUE EXPENSES.—Turning now to the expenses recorded upon the debit side of the Profit and Loss Account, these may be conveniently classified under the following headings :—

- (a) Expenses that are properly chargeable to the period under review.
- (b) Expenses which may properly be spread over a term of years.
- (c) Undisclosed and contingent liabilities.
- (d) Depreciation.
- (e) Losses arising by fluctuation of floating assets.

(f) Losses arising by fluctuation of fixed assets.

(g) Reserves for losses.

(h) Preliminary expenses.

With regard to (a), it is obvious that these amounts should all be charged up against the current year's revenue, and the steps which have been indicated in the preceding chapters should be taken to see that everything coming under this heading has been so charged.

(b) It should be remembered that the onus rests upon the directors and Auditor to justify this class of expenditure not being included as a charge against the current profits, and therefore that the Auditor must satisfy himself as to the sufficiency of the reasons advanced for its exclusion before passing the accounts. Examples of items which may be properly held in suspense are dead rents paid in excess of royalties by collieries and similar undertakings, where there is a reasonable ground for supposing that they can be redeemed out of future earnings; and also special expenditure in the way of advertising some new venture or undertaking, which, it is estimated, need not be maintained after it has been once established. With regard to the latter, however, especial care is necessary with a view to seeing that a sufficient sum is written off annually, as it not infrequently happens that the expectations of the managers are not realised, and that the permanent cost of advertising is far more than had been anticipated.

It is unnecessary to add anything upon either (c) or (d) to what has already been said in the preceding chapters, where both matters have already been very fully dealt with.

Passing on to (e), it may be pointed out that, inasmuch as the definition of "floating assets" is that class of assets which it is the object of the undertaking to convert with all convenient speed into cash, it is obvious that, so far as possible, nothing in excess of the actual current market value should be attached thereto upon the face of any Balance Sheet. Special circumstances may occasionally modify this, where at the

moment of balancing there has been a wholly unexpected and *temporary* fall in value which has been recovered before the certifying of the accounts. It is probable, however, that it is only in connection with the treatment of foreign exchanges that this principle can generally be safely applied.

(f) Concerning this item, it is thought that, so long as the permanent earning capacity of the fixed asset has not diminished, it is quite unnecessary for any provision to be set aside, with a view to making good a loss which may have occurred by reason of the fluctuation of the value of such assets. Certainly the legal decisions which have been given under similar circumstances would appear to support this view. It is important to remember, however, that, if the views already expressed with regard to fluctuations *upwards* in fixed assets have been disregarded, and credit has been taken for such fluctuations as a profit, then *a fortiori* is it necessary that fluctuations downwards should be given effect to.

(g) With regard to reserves for losses, as has already been pointed out, it is very important that ample reserves should be made to meet all reasonable contingencies before allocating profit for purposes of payment of dividend. The only thing that appears to call for attention here is that in some cases—although, no doubt, improperly—what is really a reserve against loss is described upon the face of a Balance Sheet as a “Reserve Fund”; under no circumstances, however, must such co-called Reserve Fund be encroached upon for the purpose of equalising dividends, unless the Auditor is satisfied that a sufficient balance remains to meet any reasonable expectation of loss that may occur.

(h) Under almost all circumstances it will be found usual to write off a portion of the amount incurred by a company in preliminary expenses, say, one-third or one-fifth, in each year's accounts until the amount is wholly extinguished. There is no compulsion, however, that this course should be adopted, although it is certainly one to be recommended; and it may be added that, should the first year's accounts show a loss, it is distinctly preferable not to obscure the actual facts of the case

by increasing such loss by writing off any portion of the preliminary expenses. It is, of course, impossible to write them off except out of profits, and the attempt should, therefore, not be made upon paper. *Per contra*, where there is a Reserve Fund and the accounts for the current period show a loss, it is thought that a transfer of such loss should be made to the debit of Reserve Fund, so far as the latter is sufficient for the purpose, it being a contradiction in terms to state a loss upon one side of the Balance Sheet, and a Reserve Fund (*i.e.*, undivided profits) upon the other side.

CHAPTER IX

THE ATTITUDE OF THE AUDITOR.

IN the foregoing chapters the object, extent, and manner of conducting an audit have been dealt with, and also—so far as the space at disposal permitted, and the general scope of this work appeared to justify—such modifications of, and departures from, the normal plan as are necessary to adapt it to the peculiar requirements of any individual audit with which the reader is likely to be concerned. The position of the Auditor himself will now be more particularly considered.

WHO MAY BE AN AUDITOR.—Auditors may, for general purposes, be divided into three classes:—

- (a) Amateur Auditors.
- (b) Professional Auditors.
- (c) Official Auditors.

It will be well to say a few words about each class before proceeding further.

AMATEUR AUDITORS are a class to whom the author has no great desire to express either affection or respect. He has seen too much of their shortcomings, and of the inexpressible misery and distress that has been caused by their scandalous incompetency, to feel any desire to deal gently with their failings. Auditing is much too serious a matter to be trifled with; the evil that can be wrought by an incompetent Auditor is hardly less vital—and is infinitely more extensive—than that which may be exercised by an unqualified medical

practitioner. The latter, if he be the possessor of an extensive practice, might possibly poison a hundred or so patients in the course of a long career; but the former can, while merely confining his attentions to the affairs of one undertaking, readily accomplish the ruin of tens of thousands and the starvation or suicide of scores in a much shorter period.

Some may think that this is over-stating the case, and will say that there are many amateur Auditors who are both capable and conscientious. It is not attempted to dispute the fact that the number of amateur Auditors who are known to have failed to justify the confidence reposed in them is altogether insignificant as compared with the number who are still discharging their functions to the satisfaction of all concerned. It may, however, be remarked that "the satisfaction of all concerned" does not go for much: the Auditors of the Portsea Island Building Society, the Cardiff Savings Bank, the Rock Investment Trust, and a host of other disastrous undertakings, exercised their functions, presumably, "to the satisfaction of all concerned" (especially of the criminals) until the moment when the crash occurred; and it is worthy of note that the crash never does occur until the defalcator has taxed his milch-cow beyond its strength, and that when it does occur, it is not the amateur Auditor who has brought it about. In fact, until the defalcator is fool enough to kill his golden goose, the amateur Auditor always does "continue to discharge his functions to the satisfaction of all concerned"; but does that prove the said Auditor to be discharging his functions either capably or conscientiously? Assuredly not.

Again, is it not a fact that, as a class, amateur Auditors have been shown (by indisputable statistics) to be more often concerned in cases of disaster than professional Auditors? Is it not almost invariably the case that, where professional Auditors are concerned, they have themselves detected the frauds, while with amateur Auditors the crash almost invariably comes from without?

As, however, this work is primarily intended for the use of professional Auditors—to whom, alone, the perusal of any book

upon auditing would be likely to confer any practical advantage—the subject need hardly be pursued further. The following quotation from a lecture by the late Mr. JOSEPH SLOCOMBE, F.C.A., will, however, not be without interest in this connection. Speaking of amateur Auditors, Mr. SLOCOMBE said, some years ago: “Their number is thinning down year by year, and some of you may probably live to see the day when the amateur Auditor will be almost as extinct as the dodo. The non-professional Auditor is generally a man of business—frequently retired—whose friends think he has an aptitude for figures and investigation. Sometimes—indeed often—the friends are right, and it has been my lot to meet with non-professional gentlemen in the capacity of Auditors whose painstaking sagacity and skill would be creditable to any trained accountant: but I could tell humorous stories of another section of this class—gentlemen whose capacity for auditing the condition of the sherry (which in their case generally accompanied the audit) was doubtless excellent, but whose ability to audit any set of accounts did not exist outside the imagination of the friends who had been instrumental in their appointment.

“The experience of later years has shown that unprofessional audits are generally incomplete and frequently worthless. Worthless in cases such as I have just referred to, and incomplete—except in small matters—because the gentlemen appointed have not either the time, the inclination, or, so to speak, the machinery for that thorough examination which we know to be essential if an audit is to be effectual and reliable.”

All professional Auditors would like to share Mr. SLOCOMBE's pious hope for the ultimate extinction of the amateur Auditor; but some will doubt whether that consummation is very appreciably nearer than it was when the words quoted were spoken—already some seventeen or eighteen years ago. A step has, however, been made in that direction lately, for the Building Societies Act 1894 now requires that at least one of the Auditors of every society shall publicly carry on business as an accountant, and if accountants could only agree among themselves a further development in the right direction might reason-

ably be expected in the immediate future. In practice this provision is readily evaded, but it is something to note the obvious good intentions of the Legislature.

PROFESSIONAL AUDITORS are a class with whom the reader may fairly be considered to be well acquainted. Both on account of their special training, and on account of the fact that their energies are not distracted by other, and dissimilar, occupations, they are *par excellence* the ideal Auditors. Incidentally, the peculiar facilities they possess, in the shape of a large staff of specially trained assistants, place them in the position to thoroughly perform audits of a magnitude that could not conscientiously be undertaken by any one man, no matter how skilled.

OFFICIAL AUDITORS are a class that need not be considered here at any great length—the author's sole object being to produce a work of practical utility to the profession.

Official Auditors are employed to audit the accounts of all local authorities, with the exception of municipal corporations, but the general lines followed in these audits appear to be entirely different to what would be ordinarily understood by that term. As has been already stated, the object of an audit, properly so-called, is primarily to detect technical errors and errors of principle in the preparation of accounts, and to discover fraud, either in connection with the accounts themselves or in the handling of the money belonging to the undertaking. It is only indirectly (where at all) that it becomes the Auditor's duty to consider in detail the legality of the acts of those responsible for the conduct of the business. Official Auditors are, however, almost invariably barristers, and the most important part of their duty appears to be to scrutinise the various transactions, with a view to seeing that they are not *ultrâ vires*. This is, of course, a very important matter in connection with local authorities, but it is to be regretted that the attention of official Auditors should be—as in point of fact it is—almost entirely restricted to a scrutiny of the accounts from this aspect, with the result that, although the accounts are supposed to be checked with a view to detecting error and

fraud, it has frequently transpired that dishonesty has remained undiscovered for a very considerable period. It is suggested that, for the accounts of local authorities to be really effectively audited, the investigation of the official Auditors, with their legal training, should be confined to a scrutiny of the various transactions from this point of view, the actual checking of the accounts themselves being performed by professional Auditors, who by their training are far better qualified than any lawyer to detect both errors in bookkeeping and dishonesty on the part of those having the handling of money.

THE AUDITOR'S QUALIFICATIONS.—Upon this point a considerable quantity of professional literature already exists. The subject has been touched upon in almost every presidential address delivered since the foundation of the Institute and its various local offshoots. It is not, therefore, proposed to consider the subject at any great length (for, there being no essential difference of opinion upon the matter, such a course appears to be uncalled for), but rather to briefly indicate the qualities that go to make an efficient and a successful Auditor.

FIRST, then, it is very generally conceded that an exhaustive knowledge of every department of bookkeeping is the very "A B C" of the Auditor's art.

SECOND in importance, probably, is a thorough acquaintance with various statutes regulating the different undertakings in which the Auditor may be concerned.

THIRDLY, although this point has been bitterly contested by some, a sufficient knowledge, not only of business generally, but of the especial way in which various particular businesses are conducted. In his presidential address at the first provincial meeting of the Institute (in October 1886), Mr. FREDERICK WHINNEY, F.C.A., clearly advocated this doctrine when he said: "No accountant can successfully carry on his practice in all the above-mentioned branches unless he is a person of considerable knowledge, skill, and experience, for he

must be not only acquainted with bookkeeping, which is to him as the alphabet only ; but, to put it very briefly, he must have some general knowledge of various trades and their customs . . . He ought also to have some knowledge of the practice of the Stock Exchange," and so on. No unprejudiced person would deny the advantage of such a knowledge as is here advocated ; the only question being whether the standard set is so high as to be virtually unattainable, and, consequently, impracticable. The reply to this is that, in accountancy, as elsewhere, it is only he who aims at absolute perfection who can expect to attain even to a decent mediocrity. A complete knowledge of everything is not readily attained in three-score years and ten, and is not to be expected as the result of five years' study under articles ; but the author never yet heard it seriously suggested that the standard set for the Final Examination of the Institute indicated the limit of desirable or useful knowledge. Only let the accountant make the most of his opportunities—and he will find that liquidations and bankruptcies, as well as audits, will afford him many—and he will be surprised at the amount of knowledge he can acquire, even in a short time, and perhaps even more astonished at the vast amount of service such knowledge will be to him in his profession.

LASTLY, but not least, may be placed those desirable qualifications of the Auditor which are not acquired by careful study, but, rather, by *living*. Tact, caution, firmness, fairness, good temper, courage, integrity, discretion, industry, judgment, patience, clear-headedness, and reliability. In short, all those qualities that go to make a good business man contribute to the making of a good Accountant ; while that judicious and liberal education which is involved in the single word "culture" is most essential for all who would excel. Accountancy is a profession calling for a width and variety of knowledge to which no man has yet set the limit ; the foremost Accountants are not ashamed to say that, like Epaminondas, they "learn something in addition every day" ; let us, therefore, see no shame in following their example.

AUDIT CLERKS.—It will not be amiss, before leaving this subject, to consider, very briefly, the desirable qualifications of an audit clerk. Conscientiousness may be placed in the foremost rank. A large amount of uninteresting detail must inevitably form a part of the clerk's daily routine; and the fact that the greater portion of such work may generally be scamped, without any great danger of detection, affords considerable temptation, both to the naturally slow worker, and to the gentleman of elastic conscience who wishes to make a little time for himself. Reliability is the first requisite in a clerk, and the clerk who wishes to get on must endeavour to earn a reputation for being "safe." Next, the clerk would be wise—especially the young clerk—not to get too friendly with his client's staff. Let him be cautious of accepting favours, and *most* cautious of accepting presents—which might easily drift into bribes. In this respect clerks may sometimes find themselves in a very difficult position (more perhaps from force of circumstances than from weakness of character), and the possibility of such an occurrence adds another reason to those mentioned in the first chapter, to the desirability of occasionally changing the rounds of the audit clerks. Imagination (under proper control) is another very desirable quality in a clerk; for, without it, he is apt to become a mere machine, and consequently absolutely useless to the Auditor.

THE AUDITOR'S POSITION.—The position of the Auditor varies to a certain extent with the nature of his appointment, and it will therefore be well to consider the circumstances separately.

THE AUDITOR TO A SOLE TRADER will, in almost every instance, receive his appointment from such sole trader in person; the appointment being—in the absence of stipulation to the contrary—for the period covered by the Profit and Loss Account, but renewable upon the same terms for each successive period, unless a contrary arrangement be made. The fee for the first audit is sometimes settled beforehand but more usually left open until the time occupied has been ascertained, the fee for subsequent audits being usually arranged after the

completion of the first audit. Naturally, the fee charged will be a matter of arrangement; but, in the event of no definite sum having been agreed upon, the Auditor would—in a case of disagreement—be entitled to such sum as a jury would award, which would probably be the usual professional charges. There would be no especial limit to the responsibilities of an Auditor to a sole trader: if he certify a set of accounts as correct, any third party (*e.g.*, a bank advancing money) relying upon his certificate, would probably have exactly the same right to expect the accounts to be accurate as though the audit had been performed in pursuit of their own instructions. This is a point that should not be lost sight of, as one is very apt to rely upon the unsupported word of one's own client. At the same time there is no reason why *partial audits* (the results of which are not certified) should not be made in the case of sole traders or firms, provided there is a clear understanding between the client and the Auditor as to the extent of the latter's examination. An Auditor may resign his office at any time, but it is doubtful whether he could then claim to be paid for the time occupied upon an uncompleted audit. On the other hand, the client may at any time discharge his Auditor, but he would probably be held liable for the whole fee of the current period, if the audit had been actually commenced.

THE AUDITOR TO A FIRM is usually appointed by the mutual agreement of the partners: but, occasionally, by the articles of partnership themselves, or by one particular partner. If appointed Auditor *to the firm*, he must, however, in either case, consider *each* partner as his client, and protect the interests of each accordingly. The same conditions as to term of agreement, responsibility, fees, and resignation, obtain to the auditorship of firms as were mentioned in the previous paragraph; but it would seem that any one partner would have power to bind the firm as to the amount of the fees—except, perhaps, where the appointment lay in the hands of one partner, when the consent of such partner would probably be required. Probably no one partner could discharge an Auditor without the consent of all his co-partners.

This seems the proper place to point out that in practice it not infrequently happens that, at all events, the letter, if not the spirit, of partnership agreements is broken from time to time; and, so far as these infractions of the agreement relate to accounts, it is clearly the duty of the firm's Auditor to draw attention to the position of affairs in his report. The most usual irregularity of this description is for one or more of the partners to exceed the amount which they are entitled to draw on account of profits; and, although this overdrawing need not necessarily imply bad faith upon the part of the partner concerned, it is important for the Auditor to draw attention thereto, if only for the sake of equitably adjusting the respective interests of the partners. Even where the partnership articles do not provide for interest upon either capital or drawings, it would be well to point out that, as a matter of equity, it is desirable that interest should be charged upon any excess of drawings over the authorised amount, inasmuch as these are clearly in the nature of a loan from the firm to the individual partner, and should, therefore—as a matter of right—carry interest in exactly the same way as the law provides that loans from the partners to the firm shall carry interest at the rate of 5 per cent. in the absence of express stipulation to the contrary. Any irregularities of this description should therefore be reported to all the partners; and, as a matter of convenience, it would appear to be desirable that such report should precede the actual closing of the accounts, so that the instructions of the firm may be taken upon the point and given effect to before these accounts are finally certified. It is very desirable for the Auditor to see that the accounts, after being finally agreed to, are signed by all the partners.

THE AUDITOR ON BEHALF OF CREDITORS.—It not infrequently occurs that a retiring partner, who leaves a portion of his capital in the firm, or a creditor who makes an advance to a firm, stipulates that "Mr. So-and-so shall audit the accounts." Unless the contrary intention be very clearly expressed, the Auditor so appointed would act on behalf of both the firm and the creditor. In such a case it is very desirable that the amount of the fee be arranged beforehand,

and it would not be wise to leave it an open question as to who was to pay it. Under the circumstances the firm could not, of course, remove the Auditor without the consent of the creditor; nor, in the absence of a special provision to that effect, could the creditor do so, and in any case he would probably be obliged to indemnify the firm against any extra expense occasioned by his so doing. The position of the Auditor, in such a case as this, closely resembles that of the Company Auditor, except that the creditor would be entitled to the fullest possible information, while it is sometimes a question as to whether shareholders have an equally extensive right.

THE AUDITOR OF A COMPANY is subject to the rules and regulations of that company, and to such further statutory provisions as may apply to the particular class of undertaking. The usual practice is for him to be appointed, in the case of a new company, by the directors; but he is subject to re-election at each successive annual general meeting, and at any such meeting the shareholders may (theoretically), if they so please, appoint another Auditor. Unless the remuneration of the Auditor be fixed at the time of his appointment, or by the Articles of Association, he is entitled to a reasonable remuneration; but if appointed "at such remuneration as the shareholders may think fit," he is entitled to such sum as the general meeting may award him—and no more. Directors have no power to dismiss an Auditor, once appointed; but, apparently, an Auditor may resign at any time, although probably at the loss of his fees for the uncompleted work. A casual vacancy has usually to be filled by an appointment at an extraordinary general meeting, but many articles of association give the directors power to fill a casual vacancy. To a great extent it rests with the directors to decide how much information shall be supplied in the published accounts; but the Auditor must not lose sight of his individual responsibility, and he should never certify a Balance Sheet to be "full" merely because he considers it to be as "full" as he may think it expedient for it to be. Rather let him, in such a case, certify the Balance Sheet, "in his opinion, to be a fair Balance Sheet, and to

sufficiently disclose the financial position of the company." On the other hand, he should be particularly careful to guard against juggling with words, and so appearing to give a full certificate, when in reality he is "making himself safe," or "hedging" behind a certificate which, when carefully analysed (and only then), is found to be most qualified. He must, in every case, be satisfied in his own mind that the accounts are correct, and fairly stated.

Reverting to the appointment of Company Auditors, it may be pointed out that there is nothing in the Companies Acts, as they at present stand, which makes it necessary that an Auditor should be appointed at all, except in the case of Banking Companies registered under the Act of 1877. But "Table A"—which is a *pro formâ* set of articles of association—does provide for the appointment of an Auditor, and in point of fact it is very unusual for any special articles to be registered which do not also similarly provide. It by no means follows, of course, that the provisions of "Table A" are copied into the various special articles of association that are registered; but it is customary to follow "Table A" fairly closely in this respect.

It is, of course, impossible to enter in detail here into all the variations of these *pro formâ* regulations which may appear in different articles of association, but the more usual modifications are the following:—

In the case of a private company (and particularly in the case of a "one-man" company) it is sometimes provided that a director or other officer of the company may act as Auditor. There are obvious objections to the Auditor being connected with the management in any public company, but with regard to a "family" company these objections are, to a great extent, removed. By far the most usual modification, however, is in Article 90, it being, in fact, the rule rather than the exception to provide that in the event of a casual vacancy occurring in the office of Auditor, the directors themselves may fill up that vacancy. This is a very convenient course to adopt, but it is

open to the objection that directors who have had a serious difference with their Auditor upon a question of account, may induce him to retire rather than thresh the matter out thoroughly, and then appoint a more complaisant Auditor in his place, without the shareholders hearing anything about the matter.

The provision of Article 93, that the Auditor shall be entitled to "employ Accountants or other persons" to assist him in investigating the books at the expense of the company, obviously dates back to the time when lay Auditors were the rule rather than the exception. It is very rare to find a provision of this kind in any articles of association now.

It has been settled by the Court of Appeal, in the *Kingston Cotton Mill* case, that the Auditor of a company appointed under a normal set of articles of association is an "officer" of that company, and the same Court in the *Western Counties Steam Bakeries* case decided that the Auditor is *not* an "officer" of a company within the meaning of the Companies Act 1890, even if he has performed the duties of an Auditor and held himself out as such, if in point of fact his appointment has been irregular, and not in accordance with the regulations of that particular company. With regard to both these decisions it may be added that, until judgment has been given on the matter in the House of Lords, it may well be doubted whether any final interpretation of the existing law has yet been given. Certainly, it would seem to be the view of a very considerable number of members of the legal profession that the decision of the Court of Appeal, that the Auditor of a company is an officer of a company, is one which would not be upheld in the House of Lords. Under these circumstances it seems particularly regrettable that the opportunity was not taken of invoking the decision of the Supreme Court in the *Kingston Cotton Mill* case; but the reason for this was that before the judgment of the House of Lords could be sought the Official Receiver's action before Lord (then Mr.) Justice VAUGHAN WILLIAMS upon the merits of the case came on for hearing. That being so, the respondents not unnaturally thought it more convenient to

fight out the case upon its merits, and then (if necessary) appeal to the House of Lords upon the whole matter. It will be remembered that this course became unnecessary, because the Court of Appeal decided in favour of the respondents.

Thus, although the law, as at present interpreted, states that the Auditor *is* usually an "officer of the company," the point is by no means free from doubt. That this is the case is evidenced by the fact that a clause has been specially introduced into the Companies Bill now before Parliament, stating explicitly that an Auditor is to be regarded as an "officer of the company." It is hardly likely that such a clause would have been introduced had the point been really regarded as a settled one.

AUDITOR'S NAME ON COMPANY PROSPECTUS.—The appointment of an Auditor, it will be seen, rests with the directors of a new company in the first instance. Until, therefore, the directors have passed the requisite resolution there are no Auditors to the company, and the duties of an Auditor devolve upon no one. This, in itself, is a serious defect, because for a considerable length of time the directors may thus evade any independent examination of their accounts; and in particular the practice is inconvenient because the mere mention of the name of a firm of Accountants upon a company prospectus as the Auditors of the company is, as matters stand, not the least guarantee that they will ever be appointed to act in that capacity, and certainly no responsibilities would accrue to the framers of the prospectus, for misrepresentation because an eminent name appeared on the prospectus and the appointment was not subsequently adopted by the directors. It is undoubtedly true that in many instances the name of the Auditor of a company influences persons subscribing for shares, and therefore this uncertainty is a point which would appear to call for consideration at the hands of the Legislature. As matters now stand, a firm of Accountants may have allowed themselves to be nominated as Auditors for a company, and their name may accordingly have been placed upon a prospectus; but this in itself does not constitute them the Auditors

of the company, and cases are numerous in which, in spite of a direct application to the company, it has been quite impossible for the Accountant to ascertain whether he had ever been actually appointed or not. This, of course, is a most absurd position of affairs, because if he *has* been appointed Auditor to the company he is responsible for the due performance of the duties of Auditor; and, while he may be so held responsible, he has on the other hand no means of carrying out the duties attaching to his office—or, at all events, he has no means which do not involve considerable expense upon him personally, in the event of his subsequently finding out that his appointment was not actually made by the directors. It is monstrous that Accountants should be left in such a position as this. Naturally, if they are of opinion that there is something in connection with the company which needs inquiring into, as Auditors desirous of fulfilling their responsibilities to the fullest possible extent, they would desire to go into the accounts of the company, perhaps even before its financial year had closed. On the other hand, unless they happen to be aware of the fact that they are the Auditors of the company, it is hardly to be supposed that they would incur any expense of legal proceedings in compelling the company to place its accounts before them, in the event of the directors declining to do so. The safeguard afforded, therefore, by the announcement in the prospectus that a responsible firm of Chartered Accountants will be appointed the Auditors to a company, is absolutely illusory. This, in itself, is a point which prominently calls for legislative reform, but no attempt has been made to deal with it in the Companies Bill, already referred to.

RESIGNATION OF AUDITORS.—There is nothing whatever in connection with this subject in either the Companies Act 1862, or in the new Companies Bill. Any right that the Auditor may have to resign is therefore entirely founded upon custom. It is not for a moment disputed that an Auditor would at any time have a right to resign his position, and were he to do so the “casual vacancy” which is referred to in both the Act and the Bill would, of course, arise; but it is surprising that the matter should not be dealt with more explicitly.

A point of considerable interest to all Accountants is the question as to what an Auditor ought to do when he finds himself in hopeless disagreement with the directors upon a question as to what ought to be done in the way of treating certain items in the company's accounts. Only too frequently the course is adopted for the Auditor to resign, so that the directors can fill up the casual vacancy thus caused by appointing someone who happens to agree with their own view, and so the whole matter is hushed up, and never comes before the knowledge of the shareholders at all. So long as matters remain upon the present footing, no one can possibly blame any Auditor who prefers this means of escaping a possible liability; but, on the other hand, it is obvious that this procedure effectually detracts from the independence of an audit. If there is any advantage at all in having an Auditor who is to be independent of the management, to supervise the accounts of a company, it is that, in the event of his discovering anything which he thinks should come to the knowledge of the shareholders, then that something will be placed before them. Under existing circumstances it is probably not once in ten times that an occurrence of this kind is ever found out by the shareholders. All that they know is that the accounts have been audited. They have probably quite forgotten the name of the previous Auditor, and no intimation is made to them of the fact that a change has occurred. This is a state of affairs which, so long as it continues, will effectually prevent any practical effect being given to the reforms which the Companies Bill appears to be desirous of aiming at.

The only practical way of getting rid of the difficulty appears to be to provide that an Auditor, when once appointed, should remain in office until removed by a special resolution of the shareholders in general meeting, or by the Board of Trade; or, should this be thought too drastic, then it might be provided that the Auditor remains in office for a term of, say, three or five years, which, no doubt, in the majority of cases would render the Auditor independent of every whim of the directors. As matters stand at present, it is not exaggerating the case to say that, while the Legislature is straining every nerve to throw

increased responsibilities upon Auditors, no effort whatever has been made to make it possible for them to effectively discharge the duties which are being cast upon them, without at the same time incurring serious personal responsibility.

"PRIVILEGE" OF AUDITORS.—Another reform in this connection which is earnestly needed is absolute "privilege" upon the part of an Auditor in his reports. To a certain extent he, no doubt, has this privilege at the present time; but the point is not free from doubt, and it should be absolutely free from doubt. If the Auditor is of the opinion that something which has been done by the directors, or by any outside persons, calls for the attention of the shareholders, he should be in such a position that he need feel no hesitation in expressing his view. He ought also to have a much more clearly defined right to circularise the shareholders, if need be, at any time; and more particularly in the event of his having resigned, as to the reasons for his resignation. It will, of course, be said that, were this done, many sound companies and many honest boards of directors would be placed at the mercy of unscrupulous Auditors; but there is at least no more harm in a company being at the mercy of unscrupulous Auditors, than in its being at the mercy of unscrupulous directors, and unquestionably the latter are more common than the former. Besides, the Auditor would always be liable to be called upon to justify the position which he had taken up; and nothing could protect him in the way of "privilege," if it could be shown that he had not been actuated by motives of good faith.

REMOVAL OF AUDITORS.—Passing on to the question of the removal of an Auditor. This can only be done by the company at its annual general meeting—that is to say, the only practical way of removing an Auditor is not to re-elect him when his year of office has expired. As, however, most companies only require the service of their Auditors immediately *before* such annual meeting, this for all practical purposes amounts to an appointment at will; and, in view of the fact that, under any but the most abnormal circumstances, the directors of a company can always secure a majority at a poll, it will be seen that

the Auditor (as matters now stand) practically holds his appointment from the directors, even although he may not do so in form. It is for this reason that some sort of security to the Auditor for the tenure of his office has been so strongly advocated.

DUTIES OF AUDITORS.—With regard to the question of the duties of an Auditor while in office. There being, up to the present at all events, no provision in the Companies Acts with regard to this matter, the question is entirely one of contract between each individual Auditor and the company. The basis of that contract will be construed by the Courts chiefly from the articles of association regulating that company. Table "A" deals with this subject in Articles 92 to 94, and it may be stated that most articles of association follow very closely upon these lines, although very often the question is dealt with very much more shortly.

From these provisions it will be seen that it is the duty of an Auditor to "examine the Balance Sheet with the accounts and vouchers relating thereto," and to "report" to the members upon the subject, stating in every such report whether, in his opinion, the Balance Sheet is a "full and fair one containing the particulars required by the company's regulations and properly drawn up so as to exhibit a true and correct view of the state of the company's affairs." The Auditor is further conceded the right to "at all reasonable times" have access to the books and accounts of the company, and therefore, presumably, if he thinks it necessary to attend throughout the year, it would seem to be implied that it is his duty to do so.

In this connection it may be pointed out in passing that, even with regard to such important questions as the value of assets, provision for depreciation, the assessment of profits earned, and the distribution of unrealised profits, the Courts have shown a marvellous disinclination to lay down any general rules which could be regarded as principles for the safe guidance of Auditors in the future. In carefully and laboriously shirking their duties in this respect, however, the Courts have

been most ably seconded by the Legislature, which has been particularly cautious in abstaining from laying down any exact rules as to what the duties of an Auditor may be. No doubt it has acted wisely in adopting this course, however, because any attempt to state explicitly what the duties of Auditors are in all cases would inevitably fail in not a few, and would afford the best possible excuse in such cases for the insufficiency of the audit that had been performed. Any Act of Parliament which attempts to classify the duties of an Auditor under stereotyped headings must at least profess to be at the same time exhaustive, and as the latter is impossible it seems to follow that the former is very inexpedient.

RIGHTS OF AUDITORS.—The rights of a company Auditor may be very shortly dismissed. He has but few. He has the right to hold office till the next general meeting of the company—which is of but little use, seeing how easily directors may make things impossible for him in the meantime, and how naturally disinclined any professional man would be to be removed at a public meeting. He has also the right to a remuneration at such rate as the directors or the company in general meeting may be pleased to allow. He has the right to examine the books and accounts of the company at all reasonable times (which, unless coupled with a reasonable scale of remuneration is, perhaps, rather more of a curse than a blessing), and he has the further right of making any inquiries from “directors or other officers of the company” as to matters which may not appear to be clear to him from an inspection of the books and documents. As it has been decided that neither the solicitors nor the bankers of a company are “officers of the company,” it will readily be seen that two most important sources from which the Auditor must necessarily require information under most circumstances are not legally open to him.

OTHER CONDITIONS govern the appointments of Auditors under various general and special Acts of Parliament, but these may be readily gathered from a perusal of the particular Acts involved, and—as the differences are, for the most part, trifling—need not now be entered into.

CHAPTER X.

THE LIABILITIES OF AUDITORS.

THE LIABILITIES OF AUDITORS.—Turning now, again, to the general aspect of the question, it will be well to consider the extent of the Auditor's liability in connection with accounts that he has certified as being correct.

The question appears to be capable of division under two heads, viz. :—

- (1) What is the actual extent of the Auditor's certification?
- (2) What is his legal responsibility in case of an error being subsequently discovered in accounts that have been certified by him?

To take these two points separately.

THE EXTENT OF AN AUDITOR'S CERTIFICATION.
—Unfortunately, this is a matter upon which the profession are by no means agreed; while, on the other hand, the cases that have been decided by the Courts are so few, and the questions actually at issue so narrow, that sufficient precedents are not even yet available to definitely settle the matter. At the same time, it is well to remember that, however desirable it may be to know exactly the bare extent of the legal responsibility, the real professional responsibility to clients ought always to be the ideal; and, further, an Auditor will be the worst of friends to his profession if he studiously exert himself to narrow the responsibilities, and so to dwarf the importance of his position.

The responsibility involved in certifying a Balance Sheet to be absolutely correct is so great, so limitless, that many have preferred to discard all claim to such a position of certainty, and prefer merely to certify a Balance Sheet as being "in accordance with the books." Auditors, however, will hardly require to be reminded that an investigation which had been limited to the comparison of a Balance Sheet with the books would be, for every purpose, absolutely valueless. So obvious is this conclusion that no professional Auditor would ever think of confining his investigation to this particular point, yet many experienced Auditors appear to be afraid to make any certification as to the result of such further investigation as they know to be essential. Such a state of affairs is unsatisfactory to the client and discreditable to the Auditor. Again, it is a very open question as to whether so unsatisfactory a certificate would ever have the effect of limiting the legal responsibility of the Auditor to the exact points certified. It is, at least, possible that the Court would view the matter from a broader aspect, and consider that the man who had accepted the position of Auditor—to say nothing of the fees incident thereto—had also undertaken the responsibilities of that position, and that it would be disposed to form its own opinion as to the real extent of such responsibilities. Such, indeed, appears to have been the view taken by Mr. Justice STIRLING, in the case of *The Leeds Estate &c., Society*. It would appear, therefore, that the Auditor who does not consider his investigation has been sufficiently searching escapes no liability by issuing a carefully modified certificate; and, indeed, such a course is decidedly unmanly, somewhat dishonest, and exceedingly childish. These are strong words, but not stronger than the circumstances appear to require.

When addressing the Autumnal Meeting of the Institute of Chartered Accountants in 1888, Mr. FREDERICK WHINNEY, F.C.A., expressed himself as follows: "I know perfectly well that a proper Auditor must go further (than comparing the published accounts with the books) and see that the books themselves do correspond with facts," and this view appears to

be endorsed by the legal decisions to be considered later on. As to how far it is possible for this standard to be carried into practice, there is perhaps some room for the elasticity of individual opinion, but the general statement is absolutely unassailable.

In actual practice, however, the question naturally arises: How is the Auditor to ascertain the actual facts? To which it may be replied: In the same manner as a jury—*by sifting evidence*. The chief evidence is, of course, the books (and it may be remarked, incidentally, that it is clearly the Auditor's duty to see that the accounts he certifies, in addition to being correct, are in accordance with the books), but the books must not be considered the sole source of evidence; the fact that a statement appears in the books is *primâ facie* evidence only, and must be verified, either by internal cross-examination, or by reliable and independent evidence.

The result of such an investigation will be that the Auditor has proved to himself that certain statements represent absolutely indisputable facts, and that certain other statements, *in his opinion*, appear to represent facts. Beyond this—not being omniscient—he cannot go, and should never attempt to go. Let him therefore certify that he has thoroughly examined the accounts, that they are in accordance with the books, and are, in his opinion, correctly stated: he will then be occupying a logical, manly position—far more in keeping with the dignity of his profession than that afforded by the most skilful of word-juggling.

The view laid down in the two preceding paragraphs is that which appeared in the first edition of this work, which was published in 1892, before the London and General Bank had failed, and before the celebrated case in connection with that failure was thought of; but nothing that has since occurred has in any degree tended to discredit the line of argument then taken. On the contrary, the judgment of Lord Justice LINDLEY fully endorses the author's view. This judgment, together with that of Lord Justice RIGBY, will be found fully reported in

Appendix "B"; but for the sake of clearness, and on account of its extreme importance, it has been thought desirable to reproduce here the following extract from Lord Justice LINDLEY's judgment:—

It is no part of an Auditor's duty to give advice either to directors or shareholders as to what they ought to do. An Auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question: How is he to ascertain such position? The answer is: By examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books of the company themselves show the company's true position. He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than a farce. Assuming the books to be so kept as to show the true position of the company, the Auditor has to frame a Balance Sheet showing that position according to the books, and to certify that the Balance Sheet presented is correct in that sense. But his first duty is to examine the books, not merely for the purpose of ascertaining what they do show, but also for the purpose of satisfying himself that they show the true financial position of the company. This is quite in accordance with the decision of Mr. Justice STIRLING in *The Leeds Estate Company v. Shephard*, in 36 Chancery Division, page 802. An Auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not guarantee that his Balance Sheet is accurate according to the books of the company. If he did he would be responsible for an error on his part, even if he were himself deceived, without any want of reasonable care on his part—say, by the fraudulent concealment of a book from him. His obligation is not so onerous as this.

Such I take to be the duty of the Auditor; he must be honest—that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.

What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite

suspicion, very little inquiry will be reasonable and sufficient ; and in practice, I believe, business men select a few cases at haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary, but still an Auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion ; and he is perfectly justified in acting on the opinion of an expert, where special knowledge is required.

Mr. THEOBALD's evidence satisfies me that he took the same view as myself of his duty in investigating the company's books and preparing his Balance Sheet. He did not content himself with making his Balance Sheet from the books without troubling himself about the truth of what they showed. He checked the cash, examined vouchers for payments, saw that the bills and securities entered in the books were correct, took reasonable care to ascertain their value, and in one case obtained a solicitor's opinion on the validity of an equitable charge. I see no trace whatever of any failure by him in the performance of this part of his duty. It is satisfactory to find that the legal standard of duty is not too high for business purposes, and is recognised as correct by business men.

The reasons why their Lordships felt constrained to give judgment against the defendant, notwithstanding the fact that they could " see no trace whatever of any failure by him in the performance of this part of his duty," will be considered under the following sub-heading.

Since the second edition of this work was published several important decisions with regard to the liability of Auditors have been delivered by the Courts, which—to a certain extent, although still very unsatisfactorily—tend to further define the extent of an Auditor's certification. It is thought that the points raised in these various judgments can be more conveniently dealt with under the heading of the liabilities of Auditors. It may be mentioned here, however, that, in *The Kingston Cotton Mills* case, it was decided by Mr. (now Lord) Justice VAUGHAN WILLIAMS that although the directors of a company were justified in accepting the certificate of the managing director as to the amount of stock in hand, the Auditors were—at all events in that particular case—not so justified, and that although their certificate was qualified accordingly ; but this decision was over-ruled by the Court of Appeal.

An interesting side-light upon the exact extent of an Auditor's certification is afforded by the proceedings of the Select Committee of the House of Lords appointed to inquire into Company Law Amendment, upon the occasion of the examination of Mr. FREDERICK WHINNEY, F.C.A. The following extract from the published report of these proceedings will be found of no little interest, but it is important to remember that, although some of the Law Lords have here expressed themselves in terms that appear to be widely different from those which have from time to time been used by other of Her Majesty's Judges, they are not speaking *ex cathedra*; and further that, although the distinct suggestion is that, should a case be brought before it, the House of Lords might see fit to over-rule some of the decisions already given by the Court of Appeal, it does not necessarily follow that their Lordships would adhere to those views (as expressed below) when the time came:—

Passing to clause 29, which deals with the appointment of Auditors, he suggested the addition of words to the effect that, unless it was otherwise provided by the articles of association, one of the Auditors or the Auditor, if there was only one, should be a professional accountant, and should not necessarily be a shareholder. In support of that proposition, he pointed out that joint stock enterprise had grown very largely of late years, and he maintained that very few Balance Sheets could be audited properly except by a professional accountant. He went on to suggest the insertion in the Bill of a provision that no Auditor, other than the retiring Auditor, should be appointed at a general meeting, unless notice had been sent out to the shareholders with the notice of meeting. That, he said, was brought forward with the object of preventing the question of the Auditor being "rushed," as was sometimes the case at present. The Bill provided that there should be a Balance Sheet containing all details—technically, what was known as the Trial Balance. It was scarcely necessary to provide for that by legislation, because a Balance Sheet could not be made out unless the details were given. As to the duties of Auditors, the Bill proposed that they should use reasonable diligence with the view of ascertaining that the books of the company had been properly kept, and recorded correctly the financial and trading transactions of the company. The latter part of the section he did not object to, but he thought the words "properly kept" should be omitted. "Properly kept" was a vague term, and the section would be quite sufficient to meet the difficulty without its insertion. It would be the duty of

the Auditors to say that the books had not been properly kept if that was the case.

The Bill cast upon Auditors the duty of checking the Balance Sheet, including the amount of debts due to the company after making a proper deduction for debts considered to be bad or doubtful. It would be impossible for the Auditors to do that in the case of large companies, where the debtors numbered, say, 1,000. In the case of banks, for instance, where the number of debtors was very large, it was found necessary to keep an aggregate account of debtors, showing the total amount due to the company by its debtors. The Auditors would have to take that account, and schedules would be prepared, and, if necessary, would be tested afterwards. The duty should not be thrown upon Auditors of checking every balance. In one case he might mention the debtors numbered 750,000. (Laughter.) It should be sufficient if they gave a certificate to the effect that they had used all reasonable care and diligence in ascertaining that the Balance Sheet was true.

Lord DAVEY: I should like to ask whether you conceive it to be the proper duty of an Auditor to say not only whether the books are properly kept, but to go into questions behind the books, and say whether the assets are properly valued?—I do not know that I can give a better definition of the duties of the Auditor than that laid down by Lord Justice LINDLEY. He said that it was the duty of an Auditor to be honest, to exercise all reasonable care and skill to ascertain that that which he certifies is true, and to exercise all reasonable care and skill in ascertaining the truth.

Lord FARRER: That is all very well; but what is the truth which he is to ascertain? Lord DAVEY: Yes; that is it. Can he, for instance, when the properties are valued at a certain sum in the books, and on the face of the books are properly valued, can it be his duty, not being a valuer, to go into the question of value and say that the directors have put too high a value on the real estate?—No; I do not think so. It would be giving the Auditor a different position from that which it was contemplated he should have—namely, that he should examine the accounts of the directors and see whether they are correct. Anything calculated to arouse his suspicion he ought, of course, to look into.

Lord FARRER: After all, the responsibility lies with the directors?—Not altogether with the directors. There are the managers of the company.

Lord FARRER: Do you wish to place the Auditor in the position of an administrator, who is to check the directors in their management of the company?—Certainly not.

LORD DAVEY: Is not the sounder principle this—that the Auditor is bound to know everything the books tell him, to have all the suspicions that the books suggest, and to make all the inferences to what he finds in the books would lead him?—I think that would cover the whole of his duty. I think it is his duty not to certify a Balance Sheet until he believes it to be true, and he has taken all reasonable care that it is so. He is bound to see that the Balance Sheet is brought before the shareholders in such a form that they themselves can exercise their judgment upon it.

The next suggestion he had to make was that the pains and penalties of Auditors should be modified. At present the Auditor was supposed to be responsible if dividends were paid out of capital.—LORD DAVEY: Is he? I never knew it.—THE LORD CHANCELLOR: Putting aside fraudulent connivance, what do you suppose to be the responsibility of an Auditor?—The witness: That if dividends have been paid out of capital, assuming, of course, that the company is wound up, the directors and Auditors are responsible for the amount of the dividends so paid, subject to the Statute of Limitations in favour of the Auditors.—LORD DAVEY: Where do you find that?—THE LORD CHANCELLOR: I am not aware of any such law. I am not aware of any case in which the innocent mistake of a director has been held to be the subject for an action.—The witness: There was a case before Mr. Justice STIRLING.—LORD DAVEY: There there was fraudulent connivance.—The witness: I think there was not connivance, but that the Auditor himself was ignorant.—THE LORD CHANCELLOR: To me it is a startling suggestion that for an innocent mistake an Auditor should be liable.

The view expressed by Lord DAVEY above was, it will be seen, that the Auditor is bound to know everything the books tell him, to have all the suspicions the books suggest, and to make all the inferences to which all that he finds in the books would lead him. This, taken by itself, is a somewhat narrower view than had been previously suggested in the course of this chapter—namely, that the books must not be considered as the sole source of evidence—but it is thought there is very much less difference between these views than is at first apparent, and that Lord DAVEY's view that the Auditor should "have all the suspicions which a careful examination of the books would give him" amounts to very much the same thing as the opinion, already expressed in these pages, that the books themselves are *primâ facie* evidence only, and must, in all cases of doubt, be verified by independent inquiry.

AUDITOR'S LIABILITY FOR DEFALCATIONS OF EMPLOYEES.—The question as to whether—and, if so, to what extent—an Auditor is liable to his clients for defalcations committed by their employees, is one of very considerable importance, but unfortunately the precedents upon the subject are not sufficient to satisfactorily establish any general rule. The reports in *Ross v. Wright & Co.*, *Wilde v. Cape & Dalgleish*, and *Martin v. Isitt* (all of which will be found in Appendix "B"), may advantageously be consulted in this connection; but it cannot be pretended that there is any degree of finality about them. Pending further decisions, however, it may perhaps not unreasonably be assumed that, in this (as in other) respects, the Auditor will be liable to be proceeded against by way of action for negligence in the discharge of his duties; and, if it could be shown that the defalcations had resulted from the negligence or incapacity of the Auditor, the probability is that he would be held liable in damages accordingly. The most interesting of the three cases in question is undoubtedly that of *Martin v. Isitt*, in which the plaintiffs claimed damages by reason of the fact that the monthly audit, which the defendants had contracted to perform, had been allowed to fall into arrear, and that the defalcations had remained undetected for a longer period than, in their view, was reasonable. The case was eventually settled without any definite expression of opinion upon the part of the Judge as to its merits; but, doubtless, in so far as the delay in the monthly audit was unreasonable, the Auditor would be responsible for any loss incurred by his clients in consequence. The question is obviously, therefore, one of the very greatest importance, as showing the extreme desirability of monthly and other periodical audits being punctually proceeded with. On the other hand, a reasonable margin would, no doubt, in all cases be allowed. It would be manifestly impossible for an Auditor to commence his investigation in all cases *immediately* after the period had elapsed, and consequently it is only reasonable to suppose that some elasticity would be used in applying the general rule; otherwise the position of professional Auditors, say, in the month of January, would be a serious one.

Since the last edition of this work appeared, a further decision upon the liability of Auditors in the event of defalcations on the part of employees has been given by the Irish Court of Appeal in the case of *The Irish Woollen Co., Lim.*, a full report of which appears in Appendix "B." It is important to bear in mind that the decisions of this Court are not legal precedents in England; but, be that as it may, it is thought that the proposition previously advanced can now be entertained with even less doubt than before—namely, that where loss is incurred through the defalcations of employees, which defalcations might have been discovered or prevented by the exercise of due diligence on the part of the Auditor, the Auditor will be liable. It may also be mentioned that in this case stress was laid in the agreement between the Auditor and the company that there should be a "monthly" audit, although there appears to have been some conflict as to what was actually intended by this arrangement.

LIABILITY OF AUDITORS FOR LIBEL.—The question of the liability of an Auditor for libel or slander is one which has never yet been seriously raised, but it would seem that the ordinary rules of law would apply hereto. That is to say, that, when the alleged libel or slander is true in point of fact, and is published by the Auditor in good faith and without malice, and in the *bonâ fide* discharge of his duty, it would, no doubt, be held to be privileged. So far, the proposition is eminently satisfactory; but there still remains for consideration the position of the Auditor, assuming that he were mistaken in his facts, or assuming that he had—in all good faith—gone somewhat outside the actual scope of his duty in the particular matter. In these cases it is thought that the question would be primarily one for a jury to decide; but that every reasonable indulgence would be allowed to the Auditor who had acted in good faith and without malice. Against this, however, it may be mentioned that in the action of *Weiner v. Wurtemberg Electro Plate Company and another*, the plaintiff claimed damages against the defendants for libel, on the ground that the defendant company had instructed and authorised the co-defendants (a firm of Chartered Accountants) to issue a circular to their

customers, stating, *inter alia*, that the plaintiff was no longer in their employ, and that "the bookkeeper had already been arrested on a charge of felony." His Lordship summed up very strongly in favour of the defendants, but the jury found a verdict for the plaintiff with £50 damages. The question as to whether or not an Auditor would be held liable in any particular case is thus really more dependent upon the vagaries of the particular jury concerned than upon any settled question of law, and the position is, therefore, a highly unsatisfactory one.

It may be added in this connection that it is settled law that, when it is part of the duty of any persons to attend a meeting and to address it, any statements there made by them in good faith are privileged. As to how far this would apply to statements made by an Auditor at the general meeting of a company may, however, be reasonably doubted, inasmuch as it is by no means clear that an Auditor has any statutory right to attend general meetings. Indeed, it has been held by a County Court Judge that he has no such right; and, although this is the view from which probably few will differ, the point is by no means free from doubt. It has certainly never been settled in the affirmative.

THE PROCEDURE BY WAY OF MISFEASANCE SUMMONSES.—The passing of the Companies (Winding-up) Act 1890 has had a very important bearing upon the liabilities of the Auditors of companies registered under the Companies Acts with what may be called "normal" articles of association, and, indeed, most of the cases that have yet been decided upon this subject have been the result of procedure under this statute. It is therefore desirable to consider, before proceeding to further discuss the liabilities of Auditors, the precise nature of the provisions of the 1890 Act, and the circumstances under which they apply. The provisions in question are comprised in section 10, which is as follows:—

10.—(1) Where in the course of the winding-up of a company under the Companies Act it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager, liquidator, or other officer of the company, has

misapplied or retained or become liable or accountable for any moneys or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application of the Official Receiver, or the liquidator of the company, or of any creditor or contributory of the company, examine into the conduct of such promoter, director, manager, liquidator, or other officer of the company, and compel him to repay any moneys or restore any property so misapplied or retained, or for which he has become liable or accountable, together with interest after such rate as the Court thinks just, or to contribute sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance, or breach of trust, as the Court thinks just.

(2) The provisions of this section shall apply in the winding-up of any company under the Companies Act, whether the same is being wound up by or subject to the supervision of the Court or is being wound up voluntarily, and whether the winding-up commenced before or after the passing of this Act, and notwithstanding that the offence is one for which the offender may be criminally responsible.

The essential distinction between procedure by way of summons under the foregoing "misfeasance" section and procedure by way of action is that the former is technically a proceeding in the liquidation, and consequently, as a matter of law, all evidence used in the liquidation is evidence which can be produced in support of the summons. That is to say, that the evidence given by the respondents, either at a public examination under section 8 of the 1890 Act, or under a private examination under section 115 of the 1862 Act, is evidence in the misfeasance proceedings against those particular respondents, although not against any co-respondents there may be to the same summons.

This is a form of legal procedure which is entirely new to English jurisprudence, and also, it is believed, to that of any other civilised country. An analogy (although in a far smaller degree) exists, however, in connection with the French Criminal Law, under which a person who has been once arrested on a criminal charge is cross-examined by an examining magistrate (who is virtually a police-inspector), with a view to forwarding the case for the prosecution, and the answers given by the

prisoner to such cross-examination are put in as evidence at the trial. There is, however, an automatic safeguard to the French system that does not obtain with misfeasance procedure—namely, that the verdict has to be delivered by a French jury, who certainly under no circumstances would allow itself to be bound by what—in this country—we are accustomed to look upon as the law of evidence; and, that being so, it might well be argued that it is absolutely necessary, if crime is to be prevented at all, that exceptional facilities should be afforded to the prosecution. In this country, however, no such circumstances apply. English juries would, ordinarily speaking, be seriously prejudiced *against* any defendant who was charged with contributing either directly or indirectly to a failure by which shareholders' and creditors' money had been lost; and although no jury could be called upon to try a misfeasance summons except by consent of all parties concerned, it is to be remembered that some of the earlier recorded decisions appear to clearly indicate a similar prejudice upon the part of Her Majesty's Judges. Lest this statement should be thought too strong, it may be pointed out here that of the three earliest cases when charges of misfeasance came before the Court in connection with Auditors, the Judge in the Court of first instance invariably decided against them, while in two cases his decision was absolutely reversed in the Court of Appeal, and in the remaining case it was reversed in respect of one of the two years in which it was given, and the reasons for its being upheld in the other year were materially modified.

As a matter of fact, it seems obvious that, in the nature of things, it is impossible for any one Judge (who is a lawyer, and therefore not an accountant) to express any opinion that is really entitled to the respect of the community upon the question as to whether or not, under a given set of circumstances, an Auditor has done all that could reasonably have been required of him; and in this connection it may be added that probably no satisfactory solution of this extremely difficult problem will be arrived at until some procedure is formulated by which accountants themselves may be called in with a view to acting as assessors, if not as actual Judges, upon such ques-

tions. There is ample precedent for this innovation in the Commercial Courts and the Admiralty Courts at the present time, and it must be conceded that no commercial or marine action could possibly raise more abstruse or more technical matters than the question as to whether or not, under a given set of circumstances, an Auditor had done his duty. For the present purpose, however, it will suffice to mention that, after some considerable experience in the Companies Winding-up Court, Mr. (now Lord) Justice VAUGHAN WILLIAMS must evidently have come round to the view just expressed, or he would not, in the misfeasance proceedings brought against the directors of the *London and Colonial Finance Corporation, Lim.*, have expressed the opinion that it was far preferable for a jury—rather than any single Judge—to express an opinion upon the points on which he was called upon to adjudicate. It may be added in this connection that, as all the parties were not desirous of submitting their case to the arbitration of a jury, his Lordship was compelled to hear it unaided, and eventually decided in favour of the respondents.

It is impossible, in the space here available, to enter into detail upon all the arguments which, in point of common fairness, could be raised against the present procedure under misfeasance summonses; but, in addition to the cross-examination of the defendants without any corresponding right of examination-in-chief, and the inherent inadequacy of the tribunal before which they are arraigned, the two following may be shortly mentioned:—

In the first place, before the misfeasance summons can be issued at all, the leave of the Court has to be obtained. This is granted on *ex parte* statements made by the applicant, which are not statements on oath, or even statements of fact, but an advocate's summary of the case for the prosecution. The presiding Judge is therefore called upon to express—and does express—a *prima facie* opinion on the merits of the case before the other side has been heard; and, in the nature of things, it is not humanly possible to expect him to altogether disabuse his mind of the impression which these *ex parte* statements have created. Indeed, one may go further and say that he has

already committed himself to an expression of opinion that the applicant has a good case for proceeding. To allow that same Judge to preside at the subsequent hearing of the misfeasance procedure is as inequitable as it would be to allow a magistrate to preside at a trial over prisoners whom he had previously committed. The second objection to the present procedure is that it does not compel the applicant to define his case before coming into Court. In view of the altogether exceptional facilities possessed by the applicant for obtaining information, this appears to be wholly uncalled for in the interests of even the strictest and harshest justice ; moreover, it not only greatly increases the costs upon both sides, which under no circumstances are payable by the applicant personally, but, further, it makes the cost of these proceedings so enormous as to greatly encourage applicants in launching upon highly speculative proceedings, in the hope that the respondent will pay something in settlement, rather than face the necessary and inevitable expense.

Having now shortly reviewed the nature of misfeasance procedure, it is time to pass on to a consideration—necessarily short and imperfect—of the effect of the various decisions which have hitherto been given on the subject. All these decisions will be found fully reported in Appendix “B,” and it is desirable that those which have been over-ruled, as well as those which afford existing precedents, should be very carefully studied. The probability is that the most careful examination of the text of the various judgments will fail to deduce any satisfactory summary of the precise duty of an Auditor under general circumstances ; but, such as they are, they afford the only guide that is at present available as to the legal responsibilities of an Auditor, and—unpractical as they are in many details—the Auditor who desires to be upon the safe side would do well to see that his investigation conforms with the views there laid down as far as possible.

THE RESPONSIBILITY OF THE AUDITOR FOR ERRORS.—Having now discussed the practical extent of the Auditor’s certification, it is time to pass on to a consideration

of his liabilities, in the event of his investigation having failed to detect and expose errors or frauds.

CRIMINAL LIABILITY OF AUDITORS.—This is a question which need not long detain us, inasmuch as the reported cases are few and far between. In the *Portsea Island Building Society* case criminal proceedings were instituted against the directors and the secretary of the society, but not against the Auditors. The directors were, however, acquitted, and the case is only of interest in this connection, inasmuch as Mr. Justice HAWKINS very clearly stated, in the course of his summing-up, that the evidence before him had established a *civil* liability upon the part of the Auditor.

In the case of the *Lancaster Building Society*, the Auditor, among others, was charged with various criminal offences, but was acquitted; and the Judge in his summing-up stated to the jury that, no matter how scandalous the negligence of an Auditor might be, they would not be justified in returning a verdict of guilty unless they were satisfied that there was evidence of "not only criminal negligence, but also of fraudulent intent."

The Auditors of the two banks which recently failed in Newfoundland were also tried, in conjunction with the directors of their respective companies, and likewise acquitted.

Indeed, the only case of a criminal liability being established in connection with an Auditor, which the author has been able to find reported, is in connection with the failure of an Australian bank. Here, however, it was shown that the Auditor had not only passed fraudulent transactions, but had himself derived pecuniary benefit from at least some of these transactions. The circumstances of this case do not, therefore, consist entirely of the actions of the Auditor in the discharge of his duties, as such, inasmuch as he was found guilty of a conspiracy to defraud, and the certification of false accounts was merely an incident in such conspiracy. Had this portion of the charge stood alone, the probability is that the Auditor would have been acquitted, his conviction resting mainly upon the fact that he

conspired with others to defraud the shareholders and creditors of the company, and did, in fact, participate in the spoil. It is thought, therefore—although, of course, the paucity of decisions makes the matter still uncertain—that, in order to establish a criminal liability against an Auditor, it must be clearly shown that he has benefited by the transactions, which are concealed from the knowledge of the shareholders, or, at least, that he had criminal knowledge of the existence of such transactions, and an intent to defraud the persons interested.

CIVIL LIABILITY OF AUDITORS.—There are two kinds of procedure under which civil proceedings may be taken against Auditors for damages occasioned by negligent or unskilful discharge of the duties imposed upon them; namely, by way of action, and by way of misfeasance summons.

PROCEDURE BY WAY OF ACTION.—One of the leading cases under this procedure is the *Leeds Estate Building and Investment Society, Lim. v. Shephard*, which was decided by Mr. Justice STIRLING in 1887. This case will be found duly reported in Appendix “B,” and should receive the careful attention of the reader on account of its importance. The headnote of the official report is also of considerable interest; it reads as follows:—

“Held, that it was the duty of the Auditor in verifying the accounts of the company, not to confine himself to verifying the arithmetical accuracy of the Balance Sheet, but to inquire into its special accuracy, and to ascertain if it contained the particulars specified in the articles of association, and was properly drawn up to contain a true and accurate representation of the company’s affairs.”

That portion of the judgment which more particularly affects Auditors enforces the same doctrine in even more definite terms:—

“In each of (these) years, L. (the Auditor) certified that the accounts were a true copy of those shown in the books of the company. That certificate would naturally be understood to mean that the books of the company showed (taking, for

example, the certificate for the year 1879) that, on the 30th April 1879, the company was entitled to 'moneys lent' to the amount of £29,515 15s. od. This was not in accordance with the fact; the accounts, in this respect, did not truly represent the state of the company's affairs, and it was a breach of duty upon L.'s part to certify as he did with reference to them. The payment of the dividends, directors' fees, and bonuses to the manager actually paid on those years appears to be the natural and immediate consequence of such breach of duty; and I hold L. liable for damages to the amount of the moneys so paid."

The futility of an Auditor attempting to escape his just responsibilities by a limitation of the scope of his certificate is here most forcibly demonstrated; there are, however, two other points, which must not pass unnoticed.

FIRST, there was no question, in this case, as to the accounts being false. The matter in dispute was no moot question of depreciation, or of apportionment between Capital and Revenue; the accounts were indisputably false, and it was not even suggested that the Auditor had done his best to verify their accuracy.

SECONDLY, the immediate result of his neglect was a payment of dividends, directors' fees, and bonus. Had no such result taken place, it is by no means so certain that any liability would have accrued.

Before dismissing this case altogether, it may be well to remark that L. was allowed the benefit of the Statute of Limitations; but—inasmuch as this point was not disputed by plaintiff's counsel, and was consequently not before the Court—it does not follow that a like plea would avail upon another occasion.

Astrachan Steamship Company Case.—This was an action brought in the Palatine Court at Liverpool to recover damages from the Auditors on account of loss sustained by the company through the dishonesty of its manager. A settlement was arrived at by the parties, so that no new point was decided as

to the liability of Auditors, but it may be mentioned in passing that the Vice-Chancellor expressed some hesitation as to his jurisdiction to try the matter, and only proceeded upon being satisfied that he did so with the consent of all parties. In this case a group of steamship companies were administered by the same manager, who was eventually adjudicated bankrupt with a large deficiency, and subsequently convicted for embezzlement. It appeared that he was able to satisfy the Auditors as to the existence of the balance of cash in hand in the case of each separate company by producing to them a sufficient sum of cash, although it would have been impossible for him to simultaneously produce a large enough balance to cover the amount that ought to have been in hand in respect of all the companies that he managed. Apart from this, however, it appeared that he had made entries in the books of the Astrachan Company showing that he had borrowed certain sums from that company at interest, and the suggestion was that a transaction of this kind was sufficiently usual to make it the duty of the Auditors to call the attention of the shareholders to the fact, more especially as, there being no board of directors, the shareholders were entirely dependent upon the Auditor for the protection of their money.

PROCEDURE BY WAY OF MISFEASANCE SUMMONS.—*London and General Bank Case*.—Here it will be seen, by a careful perusal of the judgments reprinted in Appendix "B," that, in their Lordships' view, the defendant failed in his duty, not in neglecting any necessary portion of his investigation, but rather in failing to acquaint the shareholders with the results at which he had arrived. It appears that, in the first instance, the Auditor drew up a very unfavourable report, of which he sent a copy to each of the directors; but that he was subsequently induced to modify this report, and to issue to the shareholders a certificate that contained no reference to its existence. This, it appears, he was persuaded to do on the understanding that some reference would be made to the matter by the chairman at the general meeting, and because he was assured that the publication of his report would ruin the bank. At the meeting no real reference was, however, made to the

Auditor's report, and the Auditor (who was present) allowed the omission to pass and the dividend to be voted without any protest upon his part.

The Court of Appeal held that the Auditor had failed in his duty because—knowing what his report to the directors proved that he knew—he failed to place the true position before the shareholders. It was held that his certificate (to the effect that the assets were “subject to realisation”) was no true warning of the actual position of affairs, and that the Auditor had no right to depute to the chairman of the directors the giving of this warning to the shareholders. In paying the dividend in question the directors had committed a breach of trust, “facilitated, and, indeed, only rendered possible by the Auditor, who failed in discharging his own duty to the shareholders.” It was, therefore, held (following the decision in the *Leeds* case) that the Auditor was jointly and severally liable with the directors to repay the amount wrongfully distributed as dividend. It may be noted in passing that Mr. (now Lord) Justice VAUGHAN WILLIAMS' decision with regard to the dividend paid in 1891 was reversed; because, although the Lords Justices were satisfied that the accounts were incorrect, they were not satisfied that the Auditor knew—or by the exercise of due diligence ought to have known—that they were incorrect, and that no profit had been earned.

It is beyond the scope of the present work to deal with this decision further than as a precedent, and accordingly it is not proposed to discuss this much-discussed case very fully. Still less is it proposed to embark upon either an attack upon, or a defence of, the Auditor's conduct. It would seem, however, that he was hit in this case for an offence which does not really appear to amount to more than an error of judgment, and that without any expert evidence being heard as to what is the usual course for Auditors to pursue under like circumstances. There were, doubtless, technical objections to the calling of such evidence, but from an equitable point of view these objections appear to constitute a distinct hardship. How far such expert evidence would have helped Mr. THEOBALD is, however, a point

upon which some doubt may reasonably be felt. The view adopted by the Court of Appeal—namely, that the Auditor's duty is to report to the shareholders—is logically unassailable, and it may, perhaps, be noted in passing that it is the view that was strongly expressed throughout this work from the publication of the first edition to the present time.

The Kingston Cotton Mill Case.—This was a summons taken out by the Official Receiver, as liquidator of the company, applying for a declaration that the directors and Auditors of the company had committed misfeasance in sanctioning the payment of dividends, on the grounds (1) that the value of the mills owned by the company, as stated in the published accounts, was greatly in excess of their actual realisable value; (2) that the value placed upon the stock-in-trade in the published accounts was greatly in excess of the actual realisable value of such stock as existed at the time. The case in the first instance came before Mr. (now Lord) Justice VAUGHAN WILLIAMS, who decided he was bound by the previous decisions in the *Neuchatel Asphalte* case, the *Commercial and General Trust* case, and in *Wilmer v. McNamara & Co., Lim.*, and could not therefore hold that it was necessary for a company to write down the value of its fixed assets to a figure which they might reasonably be expected to realise. With regard to the stock-in-trade, however, he held that, in point of fact, the stock sheets had been falsified by the managing director, whose certificates as to the quantities and value of such stocks had been accepted by both the directors and the Auditors—the latter drawing attention to this fact in their certificate. He held that it was reasonable for the directors to accept the statements of the managing director, but that, in the circumstances of the case, it was not reasonable for the Auditors to do so. He therefore held the Auditors liable, but not the directors. In giving his decision, his Lordship was doubtless greatly influenced by the evidence given by an examiner attached to the Official Receiver's department of the Board of Trade, which was to the effect that a careful examination of the accounts would have shown that the percentage of gross profit disclosed by the Trading Accounts was so absolutely abnormal as to reasonably call for further inquiry;

and a great deal might doubtless be said in favour of this view, assuming the accuracy of the facts already stated. It is, no doubt, the duty of an Auditor to thoroughly scrutinise accounts before certifying them, and if they show upon the face of them what is apparently an extraordinary state of affairs, it seems not unreasonable to suppose that the duty is cast upon the Auditor of inquiring further into the matter ; for, although it may not be the duty of an Auditor to be suspicious, it will probably be generally accepted as a statement of principle (following the words of Lord DAVEY) that "the Auditor is bound to know everything that the books tell him, to have all the suspicions that the books suggest, and to make all the inferences to which what he finds in the books would lead him." In this case it might be held that a careful scrutiny of the accounts would have suggested suspicions, which, if once aroused, should have been thoroughly inquired into ; but against that, it must be borne in mind that Mr. Justice VAUGHAN WILLIAMS had before him the evidence of an examiner who had had upwards of two years in which to make his investigation of the accounts, and that (combined with the fact that the investigation was made after the failure of the company) may well account for facts having then come to light, which it could hardly be reasonably expected an Auditor would, in the ordinary course of business, have ascertained. Be this as it may, however, the decision was afterwards reversed on appeal. The case for the appellants was argued before the Court of Appeal (consisting of Lords Justices LINDLEY, LOPES, and KAY) on the grounds (1) that the Auditors had not failed to discharge their duty to the company, and were under no liability to make good the money misapplied ; (2) that, even if they had, the proper remedy was by way of action, and not by the summary process to which the liquidator had recourse. The Court decided to dispose of the second objection first. With regard to this, Lord Justice LINDLEY said that it had already been decided that the Auditors of this particular company were officers within the meaning of section 10 of the 1890 Act. The object of that section was to facilitate the recovery by the liquidator of assets of a company improperly dealt with by its promoters, directors, or other officers. The

section applied to breaches of trust and misfeasances by such persons. His Lordship agreed that the section did not apply to all cases in which actions by the company might lie for the recovery of damages against the persons named ; it was easy, he said, to imagine cases of breach of contract, trespasses, negligences, or other wrongs to which the section was inapplicable, and some such had been the subject of judicial decision. But he was not aware of any authority to the effect that the section did not apply to the case of an officer who had committed a breach of his duty to the company, the direct consequence of which was a misapplication of its assets, for which he could be made responsible by an action at law or in equity. Such a breach of duty, if established, was a "misfeasance" within the meaning of section 10, and, therefore, the procedure adopted by the Official Receiver in this case was not improper. This first part of the Court of Appeal's decision is of some importance, as tending to show that, where it can be established that the Auditor of a company is an "officer of the company" within the meaning of section 10, then any charge of negligence which can be brought against him in respect of the accounts may, apparently, always be dealt with by way of misfeasance summons.

Passing on, however, to the merits of the case, Lord Justice LINDLEY took quite a different view to that adopted by the Court below. He pointed out that "an Auditor was not an insurer," and that in the discharge of his duty "he was only bound to exercise a reasonable amount of care and skill." What was a reasonable amount of care and skill in any particular case "depended upon the circumstances of that case ; and, if there was nothing which ought to excite suspicion, less care might properly be considered reasonable than would be so considered if suspicion was, or ought to have been, aroused." In particular, his Lordship "protested against the notion that an Auditor was bound to be suspicious, as distinguished from being reasonably careful."

Lord Justice LOPES said it was the duty of an Auditor to bring to bear on the work he had to perform that skill and caution which a reasonably competent, careful, and cautious

Auditor would use. What was "reasonable care, skill, and caution" in any particular case "must depend upon the particular circumstances of that case." An Auditor, his Lordship said, "was not bound to be a detective; nor, as was said, to approach his work with suspicion, or with a foregone conclusion that there was something wrong. He was a watch-dog, but not a bloodhound, and was justified in believing tried servants of the company in whom confidence was placed by the company." If there was anything calculated to excite suspicion, it would be his duty to probe it to the bottom, but in the absence of anything of that kind, he was only bound to be reasonably cautious and careful.

The full text of their Lordships' decisions will be found in Appendix "B" to this volume. But it will be seen that, so far as any general principle is deducible therefrom, they are quite in accord with the views which have already been expressed in the present work.

The Western Steam Bakeries Case.—In this case the Official Receiver (as liquidator of the Western Counties Steam Bakeries, Lim.) took out a summons against Messrs. PARSONS & ROBJENT. The preliminary objection was raised by the respondents that they were not "officers of the company" within the meaning of section 10, inasmuch as they had never been formally appointed Auditors in accordance with the requirements of the company's articles of association; and although Mr. Justice VAUGHAN WILLIAMS declined to adopt this view it was the one eventually taken by the Court of Appeal, so the case was not further proceeded with.

The National Bank of Wales Case.—This was a misfeasance summons brought against a director for having permitted the payment of certain dividends without due provision for bad and doubtful debts. The Court of first instance held the director liable, and the Court of Appeal reversed the decision. Both judgments are reproduced in Appendix "B," and it will be noticed that the reasons advanced by the Court of Appeal in support of its decision are somewhat extraordinary. As, however, the Auditors were not respondents to the summons, it is

thought that no useful purpose could be served by dealing with the matter at length.

Re Joseph Hargreaves, Lim.—In this case misfeasance proceedings were taken against the Auditor for having improperly sanctioned the payment of dividends out of capital. The circumstances are somewhat unusual, in that, although it is not disputed that dividends were improperly declared, it appeared that the Auditor had never certified the accounts as being correct, and had systematically protested to the directors against the declaration of any dividend. No general meeting of the company had been convened, so that it was impossible for the Auditor to place his views directly before the shareholders. It was held that in this case the Auditor had performed the whole of the duties of his position; and the case is therefore of especial interest, as showing that it is no part of an Auditor's duty to communicate with shareholders otherwise than through the medium of the general meeting, and further that, even where there are such serious irregularities as the failure to convene a general meeting for several years in succession, it is not incumbent upon an Auditor to resign his position and to refuse to have anything further to do with the concern.

POSSIBLE LIMITS TO LIABILITY.—It has already been stated that, in the cases quoted above, the measure of damages incurred by the negligent Auditor has been the full amount wrongfully paid away in dividends. This raises the very important questions as to how far these cases can be relied upon as precedents in the event of the Auditor's negligence being proved, but

- (1) *No* dividend having been paid;
- (2) A dividend having been paid, and the company having since gone into liquidation, but there being sufficient assets to pay all costs and all creditors in full.

It is hardly to be supposed that in either of these cases the Auditor would incur *no* liability, but a very little consideration will suffice to show that a different mode of assessing damages would have to be adopted. It may be added here, however,

that although the practice of the Courts has hitherto been to give judgment jointly and severally against all co-respondents held liable for the full amount of dividends improperly paid, with costs (without any corresponding right of contribution *inter se*), it by no means follows that this course will always be pursued. The language of section 10 is "to repay any moneys . . . misapplied . . . or to contribute such sums of money . . . as the Court thinks just."

In this connection the decision *in re Moxham v. Grant* (*vide* Appendix "B") will be found of interest. Here the directors had been found liable to refund to the liquidator of the company certain dividends improperly paid out of capital, under circumstances which conveyed to the shareholders a knowledge of the nature of the source from which dividends were declared. It was held that the directors had a right to recover from the various shareholders the amount of their respective dividends.

To sum up, it does not appear that (assuming the Official Receiver, or other liquidator, is acting *bonâ fide*, and not actuated by malice) the conscientious and capable Auditor, who has endeavoured to conduct his audit upon the lines laid down in this work, need feel much apprehension as to the legal consequences arising either from a *bonâ fide* error of judgment, or from his inability to discover an exceptionally clever fraud. On the other hand, it is, doubtless, greatly to the advantage of all properly qualified Auditors if a reasonable measure of responsibility be expected from them, for there would, then, be some chance of scaring out of the field a too numerous class of so-called Auditors, whose extreme ignorance of the veriest elements of their profession is only equalled by their utter inability to appreciate the moral responsibility of their position. It is, no doubt, open to question as to whether the initiation of proceedings should not be vested in some higher and more responsible authority than at present, and there is serious room for complaint against the harshness and inequity of misfeasance procedure generally; but it is believed that abuses but rarely occur, and that, consequently, all competent and reputable Accountants may regard the matter as something that does not in any sense intimately concern them.

CHAPTER XI.

INVESTIGATIONS.

It has been thought desirable to devote a chapter to that special class of audit that is usually known as an "Investigation." The subject is one intimately connected with auditing, but possesses many peculiar features which cannot afford to be overlooked.

OBJECTS OF INVESTIGATIONS.—An investigation—so far as present purposes are concerned—may be described as "A special audit, undertaken for a particular purpose." The particular purposes for which an investigation is usually made are as follows:—

I. Upon the sale of an undertaking:

- (a) To a public company.
- (b) To a private purchaser, or purchasers.
- (c) To a continuing partner, or partners, by a retiring partner, or partners.

II. For the purpose of obtaining special information as to the position of an undertaking:

- (d) On behalf of a committee of investigation appointed by shareholders.
- (e) On behalf of a present or prospective creditor.
- (f) With a view to the discovery of suspected fraud.

The former group alone claims attention in this work.

EXTENT OF INVESTIGATIONS.—When making an investigation of any kind, it must not be forgotten that those relying upon the accountant's report will naturally, and indeed reasonably, take it for granted that, so long as they adequately explain their object in seeking his assistance, it is for him, as an expert, to decide both as to the nature and the extent of the examination itself; and, in the event of it being subsequently discovered that an investigation had failed to achieve its intended object, it would be for the accountant to show that such failure did not arise from any cause which could have been prevented by a more complete, or a more exhaustive, examination. Cases are not unknown in which a faulty investigation has been attempted to be shielded under the plea that special instructions had been given by the client, and that such instructions had been duly carried out; it being argued that where the client has given special instructions as to the course to be pursued, the accountant must be exonerated from any mishap arising from the defectiveness of those instructions. This doctrine appears to be a most dangerous one. There can be no doubt that whatever instructions the accountant may have received were intended rather as a description of the object to be effected than as a definite requirement as to the means by which that object was to be attained. It goes without saying that the best authority as to the means to be employed must be the accountant himself (who receives his instructions by virtue of his being an expert in the matters requiring investigation), and it would thus seem that—however desirable it may be that he should receive, and even welcome, suggestions as to the *modus operandi* of his work—an accountant cannot submit his professional discretion to the dictation of his clients without sacrifice of self-respect and grave danger to his clients' interests. An adequate consideration will suffice to show that the accountant who undertakes the responsibility of an investigation must not seek to shield himself from the implied responsibility of proceeding upon that investigation on the lines which his professional experience convinces him are the proper ones.

DETECTION OF ERRORS IN THE BOOKS.—Before proceeding to consider our subject in further detail, it would appear

desirable to clear up a point which has the greatest importance upon the whole question, and upon which a considerable difference of opinion appears to exist—viz., the position of the accountant who has certified as to profits which, in consequence of the falsification of the accounts investigated, have subsequently proved to have been overstated. There appears to be no decision directly bearing upon this point; but a case which came before Lord KYLLACHY at the Court of Session in Edinburgh, in 1892, is of considerable interest. The case was that of the *Edinburgh United Breweries, Lim., &c., v. James A. Molleson (Nicholson's Trustee), &c.*, and the question then at issue was as to whether the circumstance that the profits disclosed by the books of the Palace Brewery, Edinburgh, were in excess of the amount actually made was (in the absence of fraud on the part of the vendors) a sufficient ground for the cancellation of the purchase, or for damages. It will be seen that this case has only an indirect bearing upon the point now being considered; indeed, the interest which it possesses is dependent rather upon the nature of the evidence than upon the point actually at issue. Especially must it be borne in mind that, although Lord KYLLACHY's decision was upheld upon appeal, it was merely upheld because it was considered that the plaintiff had no right of action against the defendant, no opinion being expressed by the Court of Appeal upon Lord KYLLACHY's views. At the original hearing of the case it was contended on the one side that books submitted for examination by accountants were to be taken as warranted free from falsification; while, on the other hand, it was argued that it was not the custom for any such warranty to be implied, and that a proper investigation of the accounts should have disclosed the fact that the profits had been, more or less, overstated. In giving his judgment, his Lordship stated that it appeared to him that the question was as to whether it was a condition of the contract of sale, expressed or implied, that the books of the brewery were to contain no errors, or, at least, no errors that were not easily to be discovered, and he confessed his inability to discover any reason for so holding. He could find no standard according to which the purchaser's examina-

tion of the books was to be conducted, and he was, therefore, unable to hold that the plaintiffs were entitled to re-open the contract, and now raise the question as to whether a condition as to the amount of profits had been fulfilled. The chief point in this decision which is really of interest in the present inquiry is the finding that there does not exist in a contract for sale based upon a statement of profits, an implied condition that such statement is correct. Exception must, of course, be taken in the case of a fraudulent mis-statement, for naturally such contracts would be voidable upon proof of fraud. The question remains, however, that if the vendors have acted *bonâ fide* there is no redress for the purchasers if they have given too large a price for an undertaking in consequence of an incorrect statement of profits by the vendors (provided the purchasers have had an opportunity of verifying such statement), or in consequence of a statement of profits that has been falsified—it may be by some employee of the vendors, unknown to them. It would therefore appear that, in such a case, an investigation that failed to reveal the actual condition of affairs would have failed to achieve its most important object.

Opinions of Accountants thereon.—It is not proposed to fully discuss the legal position and responsibilities of an investigating accountant under such circumstances, nor to criticise the investigation that was made in this particular instance; but there is much that is deserving of attention in the various opinions that were expressed by the expert witnesses who appeared in this case. The opinions of these witnesses are shortly stated here.

Mr. WM. H. KING, A.C.A., considered that there is a difference between checking books and investigating profits, and that an investigation of profits, even if properly conducted, would not always reveal an actual mis-statement thereof.

Mr. T. P. LAIRD, C.A., gave it as his opinion that in making such investigations he did not consider it any part of his duty to go through all the books and vouchers as in the case of a regular audit.

Mr. JAMES ALEX. ROBERTSON, C.A., stated that in investigating the profits of a business with reference to a sale, his experience was that an accountant was not expected to check the books and entries for the purpose of tracking falsifications. There was a marked difference between an audit and an investigation with a view to profits. The falsifications in this case could not have been discovered without a comparison of the postings in one set of books into another, and he held that was no part of the duty of an accountant turned on to investigate profits. Personally, he always inserted the words "assuming the accuracy of the books" in his certificates.

Mr. FREDERICK WILLIAM CARTER, C.A., expressed himself as being of the same opinion as Mr. ROBERTSON.

Mr. WM. GRAHAM (of the firm of NICHOLSON, GRAHAM & GRAHAM, solicitors) expressed his opinion that accountants, when instructed to investigate into the profits of a company, were not expected to go into such details as would have been necessary to discover the falsifications in this particular case.

Mr. ALEXANDER YOUNG, F.C.A. (Messrs. TURQUAND, YOUNGS, BISHOP & CLARKE), said that it was not the custom in such cases to examine the books in detail. Accountants considered that they were entitled to assume the genuineness of the books.

On the other hand,

Mr. JAMES A. MOLLESON, C.A., thought that a proper examination would have discovered the falsifications; he considered that an accountant pursuing an investigation that would be useful would wish to *analyse* the accounts, and if this had been done the frauds would have been discovered.

Mr. RICHARD BROWN, C.A., also considered that the falsifications should have been discovered; he considered that an examination of the individual (trade) accounts was necessary to form a correct idea of the nature of a business, and had this been done the frauds would have been discovered.

Mr. DAVID SIMPSON CARSON, C.A., expressed himself as being of the same opinion as Mr. BROWN.

In speaking of the object of these examinations, the writer of an article that appeared in *The Accountant* at the time says: "What the public seem to want is, not the nearest approach to facts that can be obtained in so many days or weeks, but the nearest approach to facts that is humanly possible." This will be found to accurately express the views of the average layman.

WHO SHOULD CONDUCT INVESTIGATION.—Returning to the consideration of the objects with which an investigation upon the sale of an undertaking is usually instituted, it will be obvious that such investigations may be made either upon behalf of the vendors or the purchasers, or on behalf of both. In the case of a dissolution of partnership there would appear to be no particular objection to an accountant acting for both parties, but in all other cases it is desirable that the accountant should act upon one side only. This is probably a question upon which a difference of opinion may occur; but it is thought that the accountant who attempts to act fairly towards both parties to a sale will usually find that he has secured the thanks of neither.

Whatever difference of opinion there may be with regard to a private firm, there can be but little difference in case of a public company. It seems beyond question that the accountant who professes to make his examination on behalf of a proposed company should hold himself entirely independent of the vendors. For this reason it would seem that the regular Auditor of the vendor's accounts is not a suitable person to make an investigation on behalf of the proposed company. When an undertaking is purchased by a company, and subscriptions are sought from the public on the faith of an accountant's certificate, it is in the highest degree desirable that, whatever may happen in the future, there should be no sort of suspicion that the accountant's certificate (upon the faith of which the public have subscribed) was not altogether impartial. Moreover, it would seem that upon such an occasion much benefit

might result from the introduction of a professional expert who would come upon the scene with an absolutely open mind ; for there is a general tendency to run into grooves, and it is conceivable that an accountant whose mind was absolutely unencumbered with any previous acquaintance with the circumstances of the case might see things in a different light from that in which they had appeared to the regular Auditor.

INVESTIGATION ON BEHALF OF PROJECTED COMPANY.—For the purpose of pursuing our inquiry in further detail, it is proposed to narrow the field down to the question of investigations made on behalf of a projected company ; and the most convenient method of dealing with the subject will be to contrast the methods to be adopted in such an investigation with those ordinarily employed in a regular audit.

From a theoretical point of view there need, of course, be no difference of method ; for both audits and investigations aim at a complete disclosure of the facts. In practice, however, it is usual to restrict the inquiry, so far as is possible, without imperilling the efficiency of the examination ; and it is because the objects of an audit are not altogether the same as those of an investigation that the method adopted in each case—*i.e.*, the abbreviated, practical method—varies somewhat.

LIMITS OF AN INVESTIGATION.—A regular audit professes to discover the true position of affairs. An investigation as to profits, made on behalf of a proposed company, professes to discover the position of affairs so far as they affect the particular object in view. In some respects the narrower field of an investigation will permit the accountant to reduce the scope of his examination ; but, on the other hand, there would appear to be many points upon which a greater strictness of inquiry is necessary. Thus, supposing the accountant be acting upon behalf of the purchasers of an undertaking, he may take it for granted that the accounts submitted to him by the vendors do not under-estimate the profitable nature of the business, or the strength of its financial position. Consequently, it does not seem necessary that he should inquire with the same

exhaustiveness that he would use in the case of an audit into the completeness with which every source of income has been duly accounted for ; neither does it appear necessary for him to consider the validity of the various items of expenditure charged in the accounts, nor to check such expenditure minutely with the vouchers. On the other hand, if he is acting on behalf of the vendors, it is clearly desirable that both these points should receive careful attention, but in that case the investigation would not differ greatly from the complete audit ; for it is obvious that he could not authorise the submission of accounts to the proposed purchasers until he was satisfied that such accounts were true in all respects.

FRAUD IN ACCOUNTS.—Yet another difference between investigations and audits will not fail to strike the observer. An ordinary audit must always aim at the discovery of fraud ; but an investigation as to profits would not appear to involve any such inquiry, except in so far as the assets or profits might have been fraudulently over-stated for the purpose of concealing defalcations, or of deliberately making the accounts appear unduly favourable.

Broadly speaking, there are two ways in which books may be falsified for the purpose of concealing fraud. The first method is by falsifying the Balance Sheet, either over-stating assets or under-stating liabilities to cover the amount stolen ; the second method is by falsifying the Revenue Account, by under-stating income or over-stating expenses, so that the profit shown by the books may be reduced to the profit which was actually netted by the proprietors, after deducting the amount misappropriated by the defaulting official.

If the first method has been adopted, the purchasers will not necessarily be prejudiced, for the profits shown by the books will have been the profits actually made ; while the assets which appear in the books at an unduly inflated price will usually be guaranteed as to value by the vendors, or else vouched for by the certificate of an independent valuer. Sometimes, however, the investigating accountant assumes responsibility for the accuracy of the schedule of the book debts taken

over by the proposed company, and in such cases it will, of course, be necessary for him to carefully inquire into their correctness.

Under the second method it would appear that the purchasers would actually gain by the defalcations of an official of the vendors, for the profits earned would be in excess of those shown by the books, while the latter would form the basis upon which the purchase price for Goodwill was calculated; and, as the Balance Sheet would correctly record the financial position, there would obviously be no injustice done to the purchasers if these figures were taken as a basis for valuation. It is thought, therefore, that the investigating accountant acting on behalf of a proposed company need not trouble to go exhaustively into the question of the *bona fides* of the various expenses debited, his great object being to make sure that the expenses are completely recorded in the books submitted to him. On the other hand, he will require to look carefully into the *bona fides* of many transactions, which the Auditor would naturally pass either unquestioned, or, at all events, after due representation of the circumstances to his clients. The difficulty of the investigating accountant's position arises from the fact that his real clients (*i.e.*, those in whose interests he is acting) are an unknown, and, at that time, non-existent body. It is, therefore, obviously impossible for him to consult them in any way during the course of his investigation, and his only means of acquainting them with the result of his inquiry will be by means of his certificate.

SCOPE OF CERTIFICATE.—In making an investigation as to profits, therefore, the accountant must be careful never to lose sight of the object for which his investigation is being made. That object may be said to be to ascertain

- (a) Whether the business of the vendors is worth purchasing.
- (b) Whether such business is worth the price asked for it by the vendors.

The accountant is not actually asked to express a definite

opinion upon either of these points, for it is obviously the business of each intending shareholder to answer these questions to his own satisfaction before applying for shares, but it is pointed out that the accountant's certificate forms almost the sole basis upon which the shareholder can judge of the prospects of the proposed company, and it is therefore argued that it should be the accountant's aim to so conduct his investigation, and so frame his certificate, that the materials necessary for a correct judgment may be placed before the public.

There is yet another point which the accountant must not fail to bear in mind. Inasmuch as he may be required at any future date to substantiate the statements that he has certified, he should not fail to make the most copious notes of all that transpires during the course of his investigation. These notes should not be confined to actual figures and calculations: whatever explanations he may have received in reply to his inquiries should be committed to writing, so that they may be available if required. If this be not attended to, and legal proceedings are subsequently instituted requiring the accountant to substantiate his report, his position will not be an enviable one, for he will probably have to go over at least a portion of the ground a second time, and perhaps some of the evidence he formerly utilised will no longer be available.

LENGTH OF PERIOD TO BE INVESTIGATED.—It is generally held that it is no part of the accountant's duty to prescribe the term of years over which his inquiry should extend. It is, however, desirable to bear in mind the importance of expressly stating in the certificate the period that has been covered by the investigation; and, further, it is absolutely essential that the inquiry should be brought reasonably up to date. It may be found convenient to report only upon the results of completed years, but the odd months elapsing between the date of the last Balance Sheet and the date of the investigation must not escape notice, and if they show any material falling-off, the fact must not escape attention. It may be added here that it is very desirable that the accountant's certificate should separately state the profits of each year covered by the investigation.

METHOD OF PROCEDURE.—*Standing of Vendors.*—Before actually commencing an investigation it is very desirable to make inquiries as to the position and character both of the promoters and the proprietors of the undertaking. A man is always apt to be known by the company he keeps, and no one can afford to be mixed up with persons of more or less doubtful reputation. Moreover, if a man bears a really bad character, it may safely be taken as being at least probable that the company in which he is concerned is not likely to prove a very good investment to the public; and an accountant is not likely to do himself much good by mixing himself up with unprofitable companies.

System of Accounts.—The next point that claims attention is the general system upon which the books have been kept. And, in this connection, it may be mentioned that—inasmuch as it is very desirable that the accountant should secure the co-operation of the employees of the establishment—it is a mistake for him to abuse the system of accounts which he finds in use, in the presence of the bookkeeper. Any such want of tact upon his part is almost certain to put the bookkeeper's back up, and then, instead of information flowing in smoothly, it has to be dragged out by a course of cross-examination that involves a heavy expenditure of both time and temper.

Audited Accounts.—If the books have been regularly audited by a Chartered Accountant, it is a good plan to seek an interview with him, and endeavour to gather the precise extent of his examination, and also his general opinion upon the matter. This course is, perhaps, somewhat unusual; but clearly it cannot be regarded as objectionable, while cases may easily arise in which it might be a most useful course to adopt. For instance, if a thorough audit has been made at regular intervals by a competent and trustworthy accountant, the investigating accountant might feel fairly safe upon most matters of mere arithmetical accuracy, and confine his attention more exclusively to questions of principle and to values.

Unaudited Accounts.—On the other hand, if there has been no regular audit, and *a fortiori* if the books have not even been

regularly balanced, it seems as though he could not, with safety, neglect an absolutely exhaustive inquiry into all the facts. Of course, objections may be raised to this position, the most important being the objection that such a complete examination would occupy a much longer time than is ordinarily available for the purpose. It is, however, submitted that it is the accountant's duty to make an effective investigation—not the most effective investigation practicable in the limited time placed at his disposal—and further, that he should so conduct affairs that he need not shrink from accepting the fullest responsibility as to the extent of his investigations.

NECESSITY FOR INSPECTING BALANCE SHEETS.—Another general point to which it is desirable to draw attention is the danger of looking only to the Profit and Loss Account for information as to profits. Cases are not unknown, where the assets are taken over at an agreed valuation, in which the investigating accountant has confined his attention entirely to the Revenue Account, without concerning himself with the sufficiency or otherwise of the amounts written off for depreciation and bad debts; the result being that the certified profits "as shown by the books" were greatly in excess of the profits actually earned. The accountant who aims at something more than pocketing his fees and keeping his skin whole will not rest satisfied with that sort of investigation.

GENERAL COURSE OF PROCEDURE.—Assuming that the accountant is about to commence an investigation into the profits of a manufacturing or trading concern during the past three years, with a view to its being purchased by a joint stock company; the land, buildings, plant, and stock-in-trade being specially valued for that purpose by an independent valuer: assuming further that the accounts have been continuously audited by a firm of Chartered Accountants, who are satisfied as to their correctness: the question now comes in, What special points will the investigating accountant require to examine which do not arise in the ordinary course of a regular audit?

Taking first the Revenue Accounts for each of the three years (this is the usual period covered by these investigations),

he will compare these with each other, and see whether or no they indicate a steady or consistent condition of affairs, whether the turnover fluctuates materially, and whether increasing, at a standstill, or diminishing; whether the percentage of gross profit is fairly constant, and such as is usually earned in such undertakings; and whether the percentages of expenses and net profit to gross turnover are reasonably steady. A marked reduction of expenses during the last year must be viewed with the greatest suspicion, for such reduction, if excessive and not *bonâ fide*, may have a very serious effect upon the future prospects of the undertaking.

So far as is reasonably practicable, the accountant must examine the *bona fides* of all sales, especially those recorded during the last few months. The prices of at least a portion should be compared with current rates, and any remarkable increase in the amount of sales or in the number of new accounts opened should be regarded with suspicion. All entries "on approval" must be disallowed, and where sales are post-dated it seems essential to make sure that they have actually gone out of stock. The entries for the next few weeks after the closing of the books should be carefully scanned, and if they show an exceptionally large number of returns, and an exceptionally small amount of sales, he must draw his own conclusions as to the *bona fides* of such entries. In dealing with the question of consignments, he must remember that the goods have probably been invoiced up at selling prices, while the unsold balance can only be allowed for in the accounts at cost price. Another point which must not be lost sight of is the question of travellers' commission: care must be taken to charge up commission upon all sales that are included in the accounts. Due allowance must also be made for all outstanding discounts; and empties which are returnable, but not yet returned, cannot safely be taken credit for at the full price charged.

With regard to the purchases, the problem is similar to the sales, but somewhat simpler, because he can usually get hold of the creditor's statements. It is, however, very necessary to be

on one's guard against the omission of post-dated invoices when the goods have actually gone into stock.

Where reliable Stock Accounts and Cost Accounts have been kept, there exists a very valuable corroboration of the contents of the Trading Account; but where these cannot be obtained, the accountant must do his best with the material available.

It is especially important that the various stocktakings should be conducted upon similar lines, *i.e.*, they should be based upon the same scale of prices, due allowance being made for the depreciation of articles no longer in fashion, or in small pieces.

If the various stock-lists have been prepared upon different prices, they must be recast upon a uniform method, as any such difference may very materially alter the profits shown by the accounts. The valuation of the stock-in-trade made by the valuer should be compared with the vendor's stock-list, and if there is any material difference between the two, the accountant must not fail to examine the effect of such difference upon the accounts. Thus, supposing he arrives at the conclusion that, throughout the past three years, the stock has been consistently over-valued, say, 15 per cent., and supposing the stock is £10,000 heavier at the present time than it was three years ago, then during those three years the net profits will have been over-stated £1,500, or (say) £500 a year, which is a material difference when one comes to pay eight or ten years' purchase for a goodwill.

When the stock consists of such articles as cotton, iron, grain, lead, &c., which have a definite but unstable market value, the question of the legitimacy of profits arising from such alterations in value as may have occurred is a consideration of no slight importance. This is a point upon which the author would rather not express too decided a view at the present time, but it is his opinion that (1) no profit should be taken credit for upon the rise in value of unsold stock, although Revenue must be debited with the contingent loss arising from any fall; (2) no profit should be included as part of the trading or manufacturing profits that has arisen out of a "gamble" pure and

simple, but that gambling losses cannot safely be ignored ; (3) where any material portion of the profits has arisen from favourable fluctuations of value—as opposed to true commercial profits—it is very desirable that the two sources of profit should be distinguished in the accountant's report.

If there are any further items to the credit of the Profit and Loss Account, he will require to see that the profit has been actually netted, and that it is fairly incidental to the business of the undertaking. Even then, however, a purely exceptional source of profit (e.g., the fact, that an important exhibition had been held in that particular industry, or an altogether exceptional contract executed) should always be specially noted in the report.

Another point of no slight importance may be mentioned here, although it does not immediately arise from the preceding considerations. Where the undertaking is of such a nature that it cannot be advantageously carried on except in the present premises, the accountant should satisfy himself that those premises will be conveyed to the company for a reasonable term. No sensible man would buy the goodwill of a hotel unless he could get a long lease, if not the freehold, of the hotel premises ; while the goodwill of a music-hall held on a yearly tenancy would not usually be considered a good investment. If the lease to be granted to the company is at an increased rental, he must on no account forget to mention the fact.

Turning now to the expenses debited to Profit and Loss Account, he will require to satisfy himself that every legitimate expense was actually included. The ordinary current expenses present no especial difficulty ; if he has the accounts for the past three years he can get at them fairly well, while a study of the accounts since the date of the last Balance Sheet will probably disclose any outstanding liabilities that have been improperly omitted. Attention has already been called to the danger of a *mala fide* ruinous curtailment of expenses, so there is no occasion to again dwell upon that point.

There remain now the questions of bad debts, repairs and renewals, and depreciation. For the purpose of dealing with these points the accountant must refer to the Balance Sheets, as well as the Profit and Loss Accounts; and, inasmuch as he is no longer in the realm of cut-and-dried facts, he must use the greatest amount of circumspection in arriving at his ultimate opinion.

In dealing with bad debts, the circumstance that he is dealing with three years' accounts will help him to a certain extent, for it will enable him to strike an average, and he can compare that average with what his experience teaches him to be the average usually obtaining with similar classes of undertakings. Again, the book debts of the first year, at least, are almost certain to be either collected or else written off before the end of the third year, and he can compare the percentage of the first year's actual bad debts upon its sales with the average amount written off. Such a comparison is of necessity only tentative, but it is useful so far as it goes. Then he can carefully examine the last schedule of book debts; the chances are that he will know a very appreciable proportion of the names there set down, and if he finds that the schedule contains names that some of his other clients look upon as bad or doubtful, he must draw his conclusions accordingly, to the best of his judgment. In any case, and under all circumstances, he will require to satisfy himself that a sufficient provision for bad and doubtful debts has been debited to Profit and Loss.

With regard to the question of depreciation his position is, perhaps, a little more difficult. Speaking generally, if the values set forth in the Balance Sheet submitted to him exceed the amount of the valuer's estimate, he may add such difference to the amount of the depreciation debited to Profit and Loss during the three years under review. The method is not infallible, however, for the valuation at the commencement of the period may have been too high—in which case he will be charging an undue amount against the profits of the three years—or it may have been too low—in which case he will not have charged enough. There are, however, normal rates of depreci-

ation which may be used to verify results, and previous experience, combined with sound judgment, will probably keep him from going very far wrong. Repairs should in all cases be charged up to revenue, but actual renewals need not be, provided ample allowance has been made for depreciation.

If part of the assets taken over consists of shares in other companies, care must be taken to see that these are included in the accounts at their proper value. Where shares (perhaps unquoted shares) have been received in payment of book debts, especial attention is necessary, as the trading results are directly affected. Under no circumstances should revenue be credited with more than the normal value of the work done until the shares have been actually sold, and if the profits realised on such shares form any appreciable portion of the total profits he should mention the fact in his report.

Where patents form part of the proposed purchase, and where such patents have not been submitted to a specialist for valuation, the accountant should make it his business to see—so far as possible—that the inventions purchased are actually protected. In a recent case, a so-called patent that had been purchased by the original proprietors of the undertaking in perfect good faith was not really patented at all.

ADJUSTMENTS IN PROFITS.—For the purpose of a certificate attached to the prospectus of a new company it is usual to make certain adjustments in the statements of profits which would not ordinarily appear in the accounts of a going concern. This arises out of the difference between an investigation and an audit, the former being primarily with a view to verifying the Profit and Loss Account (and so certifying the *normal* profit of the undertaking), while the latter is—speaking generally—confined to a verification of the present position of affairs, as shown by the Balance Sheet. In order to avoid any possibility of misconception, however, it is well to invariably state what adjustments have been made in connection with profits which would not be usual in the case of a going concern.

These adjustments would, in all ordinary cases, include the amounts paid for Income-Tax, Interest on Capital, Interest on

Loans, and Partners' Salaries, which may all properly be added to the net profits, provided the fact that they have been added is clearly stated. There are, however, other points which are possibly more debatable, and which will now be considered.

Depreciation.—Under normal circumstances a certification as to net profits would appear to naturally assume that a reasonable amount had been written off such profits in respect of the depreciation of all assets necessary for the purpose of carrying on the business. It sometimes happens, however (especially where a large number of retail concerns are amalgamated, for the purpose of forming one large company), that the accounts which have to be investigated are incomplete, and that no reliable information can be obtained as to the actual value of the assets upon which depreciation ought properly to be charged; while it may be added that the normal depreciation would naturally to a large extent be based upon the actual cost of such assets to the present proprietors, whereas the depreciation which will have to be charged by the proposed company in the future will of necessity have to be based upon the amount which that company actually pays for the assets in question. Under these circumstances—and under all other circumstances where the same conditions apply—it is not merely difficult to assess the actual rate of depreciation, but actually misleading to deal with it, even where it can be assessed. That being so, it is thought better, where these conditions apply, to certify the amount of profits which have been earned *without* any provision whatever for depreciation, leaving the assessment of the amount necessary to provide for this contingency to those who may be interested in the matter.

Exceptional Losses and Profits.—It has already been indicated that the main object of any investigation is to arrive at the normal profits of an undertaking; and, that being so, it is important that any exceptional sources of profit should be excluded, while *per contra* it is permissible that wholly exceptional sources of loss should be excluded. It is very difficult to define exhaustively either profits or losses coming under this category, but the following may be included.

Exceptional Losses.—Losses not covered by insurance arising through fire, accidents to employees, or defalcations; provided a sufficient charge against profits is made to cover the amount which such insurance would have cost. Losses arising through actions at law not altogether incidental to the carrying on of the business, as, for instance, through breach of contract, infringements of patent, &c.; but, if the losses arising from these causes are included, it is essential that whatever profits may have been incurred in connection with the subject-matter of the action would be also excluded, unless the litigation resulted in favour of the proprietors of the business being investigated.

Under the heading of *Exceptional Profits* which ought to be excluded may be classified all such transactions as it is not reasonable in the ordinary course of events to anticipate will frequently recur in the carrying on of the existing business upon ordinary lines. It is naturally impossible to deal exhaustively with this class of item, but the following headings may be mentioned:—

- (1) Any profit received from a local authority, by way of compensation for compulsory removal of the business premises.
- (2) Any profit received from an insurance company in respect of a risk covered by a policy of insurance.
- (3) Any profit received in connection with the sale of a portion of the undertaking, as, for instance, the sale of a patent, or of certain limited rights to work a patent, or of any fixed assets that may have been acquired for the purpose of working any portion of the concern in question, whether that department may since have been abandoned or not.

Cash Discounts.—Where the concern in question has hitherto been hampered by want of capital, and has therefore not been able to take full advantage of the cash discounts offered, it is permissible, where the scheme of the proposed company provides for sufficient working capital, to take credit for the maximum cash discounts that might have been obtained, had

ample working capital been employed ; but advantage should never be taken of this suggestion without fully explaining the fact that credit is being taken for profits which in point of fact have not been actually realised in the past.

Generally in matters of this description there is always a temptation to emphasise the saving which may be effected in the future by more skilful management, and by the economy which might reasonably be expected to result from the amalgamation of several concerns. These, however, are matters which it is submitted ought not to form the basis of any accountant's certificate as to profits. Such certificate should be rigidly based upon facts, and although certain adjustments, as already indicated, may be desirable (and even necessary), so that a correct impression of these facts may be gathered, in view of the altered conditions which it is expected will obtain under a new company, under no circumstances whatever should the certificate as to profits degenerate into anything which could possibly be described as an estimate, or a guess of what may under certain circumstances be expected to happen in the future.

CONCLUSION.—By this time the accountant will have arrived at an opinion as to the amount of profits ordinarily earned by the undertaking he is investigating, but his work does not quite end here. As Mr. J. A. MOLLESON expressed it, when giving evidence in the case already quoted, “an accountant pursuing an investigation that would be useful would wish to analyse the accounts.” Not only is it thought that such a course is most desirable as a safeguard against fraud (where a regular and satisfactory audit does not practically remove this contingency from the sphere of possibilities), but it is also extremely valuable for the purpose indicated by Mr. RICHARD BROWN, in the same case, of revealing the general nature of the business under review.

The accountant will now have collected sufficient data to enable him to form a general impression of the business under review. He will have had ample opportunity to study the general mode upon which the business is conducted ; and he will have formed his own opinion of the *personnel* of the man-

agement; he will have ascertained the amount of capital required to conduct the business upon its present lines, and have formed his own opinion as to the scope it offers for an increased capital (if such a thing be contemplated); he will have ascertained how far the continued success of the undertaking depends upon: (a) successful competition; (b) the continuance of a monopoly; and (c) the caprice of public demand; and have formed his own opinion concerning their continuance. In a word, he will be able to gauge the probable success of the venture. The point now to be considered is how far, if at all, his personal opinion upon these points should influence his report.

If it be conceded that the object of the accountant's investigation is to supply the place of an independent examination by each proposed shareholder (as the object of a professional audit is to supersede and supply the place of a personal examination by each proprietor) it must be admitted that these opinions are entitled to some expression. Yet the expression of personal opinions should be cautious and not dogmatical, and should be very clearly separated—where expressed at all—from professional opinions given, as experts, in matters of account; and further, it should never degenerate into either estimates or prophecies. It is very difficult to lay down any general rules upon this point; but, so long as the question is considered upon its merits in each particular case, the accountant will probably not get far wrong.

The question may very possibly be raised that the accountant who pursues the course here advocated is not likely to enjoy a very extensive investigating practice. It is thought that this conclusion offers an injustice to company promoters as a class. The profession of a company promoter is a very mixed one, doubtless, but the black sheep—although naturally the most notorious—are decidedly in the minority, and there are very many promoters who would thoroughly appreciate a greater strictness in investigations, which could not fail to strengthen the confidence of the public in joint stock enterprise as an advantageous mode of investment.

CHAPTER XII.

INCOME TAX.

It is neither necessary nor practicable that any detailed consideration of so important a subject as income tax should be undertaken in this work; but it so frequently happens that Auditors—both of the accounts of private traders and those of public companies—are asked to assist their clients in connection with assessments and appeals, that the present work would not be complete without some reference to the law and practice relating to this subject. An outline of the incidence of income tax is therefore appended in the present edition, but those who desire a more complete exposition upon the matter would do well to consult MURRAY & CARTER'S *Guide to Income Tax Practice*, a reference to which will be found in Appendix "E."

CLASSES OF INCOME ASSESSABLE.—Section 2 of the Income Tax Act 1853 divides the classes of income assessable to taxation under five headings, as follows:—

Schedule A, relating to property in lands and buildings.

Schedule B, to the occupation of such lands and buildings by farmers and the like.

Schedule C, to interest and dividends payable out of the public funds of the United Kingdom, the Colonies, or any foreign State.

Schedule D, to profits accruing to a person in the United Kingdom from a trade, business, or other occupation, whether carried on in the United Kingdom or elsewhere.

(This schedule also includes interest on money and other annual profits, not included in any other schedule.)

Schedule E, relating to annuities, salaries, &c., payable out of the public revenue or by public companies.

Of these Schedule "D" is by far the most important, but it is proposed to deal shortly with each class of assessment in the first instance, and then revert to Schedule D in further detail.

Schedule "A."—The tax collected under this schedule is more generally known as the "Landlord's Property Tax." It is based upon the annual value of the lands or premises as the case may be, subject, since the passing of the Finance Act 1894, to the deduction of one-sixth in the case of houses (excluding farmhouses), and to a reduction of one-eighth in the case of lands, including farmhouses. The tax is actually collected from the tenant, but may be deducted by him from his rent when paying the same over to the landlord. It is important to remember this, as it has been decided that where a tenant pays tax under Schedule "A," and inadvertently omits to deduct it when making the *next* payment of rent due, he cannot afterwards recover the amount as "money paid for the use of the landlord." The usual basis of the assessment under Schedule "A" is the poor law valuation; but this is by no means binding upon the Commissioners, although it is the custom to adopt the poor law figures when the valuation is made throughout on the full annual value of the property.

Schedule "B" is the tax levied on the occupiers of agricultural lands, nursery gardens, &c., being an estimate of the profits earned by them, based upon the rental value of the lands held. The rate of tax under this schedule is not the same as under the other schedules, being at the present time $4\frac{1}{2}$ d. in the £ upon the amount of the rent, subject to a deduction not exceeding one-eighth thereof, which brings the net tax down to $3\frac{1}{8}$ d. in the £, as against 1s. under the other schedules.

The Act of 1887 further provides that anyone assessable under Schedule "B" may, before assessment, elect to be assessed under Schedule "D," should he prefer to do so.

Schedule "C."—The tax under this schedule is always collected at the source, and the dividends or interest coming thereunder are paid out to the various stockholders *less* income tax. If, therefore, the total income of such stockholder from all sources is such as to entitle him to abatement or exemption, it is necessary for him to apply for a return of tax, the procedure as to which will be dealt with later on.

Schedule "D" covers all cases which are not dealt with by the other schedules. The tax hereunder is, in the words of the Act, levied "for and in respect of the annual profits or gains arising or accruing to any person residing in the United Kingdom, from any kind of property whatever, whether situated in the United Kingdom or elsewhere; and for and in respect of the annual profits or gains arising or accruing to any person residing in the United Kingdom from any profession, trade, employment or vocation, whether the same shall be respectively carried on in the United Kingdom or elsewhere; and for, and in respect of the annual profits or gains arising or accruing to any person whatever, whether a subject of Her Majesty or not, although not resident within the United Kingdom, from any property whatever, or any profession, trade, employment or vocation exercised within the United Kingdom; and for and in respect of all interest of money, annuities, and other annual profits and gains not charged by virtue of any of the other schedules." It is important to bear in mind that there is a very broad distinction between the term "annual profit or gains" as used in section 2 of the 1853 Act, and the term "net profit," as ordinarily understood by business men. The latter term is in itself sufficiently vague, but many deductions which would be clearly proper before arriving at net profits from an accountant's point of view are not allowed under the Income Tax Acts. This, however, is a point which is more conveniently dealt with later on.

Schedule "E" relates to the salaries, annuities, pensions or stipends received, payable by Her Majesty or out of the public revenue of the United Kingdom (except annuities charged under Schedule C), and also the salaries of Government officials, and

the directors, managers, and other officers of public companies, including Auditors. As a matter of convenience, however, it is usual in the case of Auditors' fees, where these are received by professional accountants, for them to be included in a return under Schedule "D."

WHAT ARE ASSESSABLE "PROFITS."—It has already been pointed out that there is a material distinction between the profits assessable for income tax and what accountants would regard as the actual net profit of the undertaking. The following items, which would in the ordinary course be debited to the Profit and Loss Account are disallowed for income tax purposes:—

Partners' salaries.

Income tax.

Disbursements or expenses not wholly or exclusively laid out for purposes of trade, &c. Under this heading many classes of expenditure which the trader might consider judicious and expedient for the extension of his business would be disallowed.

Depreciation of land, buildings, or leases. Against this it must be remembered that the *full* annual value of the premises occupied may be deducted, whether that amount or a lesser amount is actually paid; the probability, therefore, is that matters come out pretty evenly in the end in this respect.

Any annual interest or annuity, or other annual payment, payable out of profits—the duty on which may, however, be deducted from the person to whom the payment is made.

Interest on capital.

Sums expended in the improvement of premises occupied for purposes of trade. Under ordinary circumstances these would be written off to Profit and Loss Account over a term of years, but they are not allowed as a deduction for income tax purposes at all.

The following deductions are, however, permitted:—

Repairs of premises used for the purposes of a trade or manufacture.

A sum for the supply or repairs of implements, utensils, or articles employed, not exceeding the sum actually expended for such purposes according to the average of three years preceding.

Bad debts, or such part thereof as shall be proved to the satisfaction of the Commissioners to be bad; also a reserve for doubtful debts "according to their estimated value."

"Any average loss not exceeding the actual amount of loss after adjustment."

The annual value of premises used solely for the purposes of business and not as a place of residence. In the case of business premises being also used as a place of residence such proportion of the annual value as the Commissioners may think expedient will be allowed up to, and not exceeding, two-thirds of the total value.

It may be added at this point that the cost of goods supplied by the business for the private purposes of its proprietors must not be taken as an expense of the business. As an example of this it may be stated that where a restaurant keeper lives on the premises, the Commissioners require that credit should be taken for a reasonable allowance in respect of the food and drinks consumed by himself and his family.

A sum representing the diminished value, by reason of wear and tear, of machinery or plant. It will be seen that this differs from depreciation, in that any shrinkage of value caused by the machinery or plant becoming obsolete is not included. The amount which will be allowed is in the discretion of the Commissioners, and is usually very considerably less than would be regarded as reasonably prudent in that particular class of business, not indeed often exceeding 5 per cent.

It is the practice to allow the cost of fire insurance premiums and local rates and taxes to be deducted from profits, although neither is specially provided for in the Act.

BASIS OF ASSESSMENT.—The basis of assessment under Schedule "D" in all normal cases is the average of the profits earned during the three last completed years of trading

immediately preceding the date of the return to the income tax surveyor. The assessment is made in advance, and is therefore subject to modification, should the estimate eventually prove to be inaccurate; this point, however, is more conveniently dealt with at a later stage.

ABATEMENTS AND EXEMPTIONS.—The following abatements and exemptions are granted when the income derived *from all sources* is less than the prescribed amount. Therefore, under some circumstances, it is desirable that the partners of a firm should obtain a separate assessment, rather than that the assessment should be made upon the firm. For example, a firm having three equal partners may earn an average profit of £1,200 per annum; unless a separate assessment was made for each partner the firm would, therefore, have to pay the tax upon £1,200. On the other hand, if each partner was separately assessed (and had no other sources of income) his return would be for £400, and he would, therefore, be entitled to an abatement as shown hereafter.

At the time of writing incomes not exceeding £160 from all sources are exempt from income tax. Incomes from £160, and less than £400, are entitled to an abatement of £160; on incomes of £400 up to and not exceeding £500, an abatement of £150; on incomes between £500 and £600, an abatement of £120; on incomes between £600 and £700, an abatement of £70; no abatement being allowed on incomes of £700 and upwards.

Another form of abatement which appears to come under this heading is that premiums paid to a British office on an insurance on the life of the person assessed or his wife, not exceeding in all one-sixth of the total income assessable, may be deducted before arriving at the amount upon which tax is payable. This benefit, however, does not operate to reduce the income for the purpose of obtaining abatement or exemption under the clauses just mentioned. For example, if the total income be £420 and £70 the annual life insurance premium, this reduces the income upon which tax has to be paid to £350; but the tax must be paid upon £200 (*i.e.*, £350 less the abatement allowed on

incomes between £400 and £500), and not on £190 (*i.e.*, £350 less the abatement on incomes between £160 and £400).

CLASSES OF UNDERTAKINGS EXEMPT FROM INCOME TAX.—Various public bodies and charitable institutions are exempt from the operations of the Income Tax Acts, and the Auditor must, therefore, see that the tax which has been deducted from any income receivable by these bodies is applied for and returned to them. Friendly societies, trustee savings banks, and industrial and provident societies are also exempt, but building societies are not.

ON THE OTHER HAND, joint stock companies are always assessed upon the amount of their actual profits, and are not entitled to claim either abatement or exemption. The usual practice is for them to deduct income tax from all dividends paid by them, and, of course, income tax should in all cases be deducted from preference dividends, and from debenture and mortgage interest; and the shareholders or debenture-holders whose total income is such as to entitle them to the benefit of exemption or abatement may apply for a return of the tax so deducted.

MODIFICATION OF ORIGINAL ASSESSMENT.—When, at the end of the year, it is found that the amount of profits upon which income tax has been paid is in excess of the actual profit for the period just closed, the trader is entitled to apply for a return of the tax so over-paid. In support of this application he must show the average profits earned by him during the past three years, including the year of assessment; and, if this average profit is less than the average profit upon which the assessment has been made, the difference will be refunded. *Per contra*, the income tax authorities are entitled to make a further assessment where they are satisfied that the original assessment has been insufficient. In practice, of course, this is but rarely done; but in the case of undertakings which are being formed into limited companies, the income tax surveyors sometimes take advantage of the profits disclosed by the prospectus to secure a further payment of income tax on the past year.

APPENDIX A.

EXTRACTS FROM STATUTES

REFERRED TO IN THE COURSE OF THIS WORK.

GENERAL.

FALSIFICATION OF ACCOUNTS ACT.

38 and 39 Vict. c. 24.

1.—That if any clerk, officer, or servant, or any person employed or acting in the capacity of a clerk, officer, or servant, shall wilfully and with intent to defraud, destroy, alter, mutilate, or falsify any book, paper, writing, valuable security, or account which belongs to or is in the possession of his employer, or has been received by him for or on behalf of his employer, or shall wilfully and with intent to defraud, make or concur in making, any false entry in, or omit or alter, or concur in omitting or altering, any material particular form, or in any such book, or any document or account, then in every such case the person so offending shall be guilty of a misdemeanour, and be liable to be kept in penal servitude for a term not exceeding seven years, or to be imprisoned with or without hard labour for any term not exceeding two years.

2.—It shall be sufficient in any indictment under this Act to allege a general intent to defraud, without naming any particular person to be defrauded.

It is further declared (section 3) that “this Act shall be read as one with the Act of the twenty-fourth and twenty-fifth of her Majesty, chapter ninety-six,” section 82 of which makes it a misdemeanour on the part of any director, public officer, or manager of any body corporate or public company, who shall “as such receive or possess himself of any of the property of such body corporate or public company, otherwise than in payment of a just debt or demand, and shall with intent to defraud, omit to make, or to cause or direct to be made, a full and true entry thereof in the books or accounts of such body

corporate or public company.” The following section (83) makes it a misdemeanour on the part of any such person, who shall “with intent to defraud, destroy, alter, mutilate, or falsify any book, paper, writing, or valuable security belonging to the body corporate or public company, or make or concur in the making, of any false entry, or omit, or concur in omitting, any material particular in any book of account or other document.” And section 84 makes it a similar offence on the part of any such person who “shall make, circulate, or publish, or concur in making, circulating or publishing, any written statement or account which he shall know to be false in any material particular, with intent to deceive or defraud any member, shareholder, or creditor, of such body corporate or public company, or with intent to induce any person to become a shareholder, or partner therein, or to entrust or advance any property to such body corporate or public company, or to enter into any security for the benefit thereof.”

REGISTERED COMPANIES.

THE COMPANIES ACT 1862.

25 and 26 Vict. c. 89.

Application of Table A.

15.—In the case of a company limited by shares, if the memorandum of association is not accompanied by articles of association, or in so far as the articles do not exclude or modify the regulations contained in the table marked A. in the first schedule hereto, the last-mentioned regulations shall, so far as the same are applicable, be deemed to be the regulations of the company in the same manner and to the same extent as if they had been inserted in articles of association, and the articles had been duly registered.

Register of Members.

25.—Every company under this Act shall cause to be kept in one or more books a register of its members, and there shall be entered therein the following particulars:—

- (1) The names and addresses, and the occupations, if any, of the members of the company, with the addition, in the case of a company having a capital divided into shares, of a statement of the shares held by each member, distinguishing each share by its number; and of the amount paid or agreed to be considered as paid on the shares of each member:

(2) The date at which the name of any person was entered in the register as a member :

(3) The date at which any person ceased to be a member :

And any company acting in contravention of this section shall incur a penalty not exceeding five pounds for every day during which its default in complying with the provisions of this section continues, and every director or manager of the company who shall knowingly and wilfully authorise or permit such contravention shall incur the like penalty.

Annual List of Members.

26.—Every company under this Act, and having a capital divided into shares, shall make, once at least in every year, a list of all persons who, on the fourteenth day succeeding the day on which the ordinary general meeting, or if there is more than one ordinary meeting in each year, the first of such ordinary general meetings is held, are members of the company ; and such list shall state the names, addresses, and occupations of all the members therein mentioned, and the number of shares held by each of them, and shall contain a summary specifying the following particulars :—

- (1) The amount of the capital of the company, and the number of shares into which it is divided :
- (2) The number of shares taken from the commencement of the company up to date of the summary :
- (3) The amount of calls made on each share :
- (4) The total amount of calls received :
- (5) The total amount of calls unpaid :
- (6) The total amount of shares forfeited :
- (7) The names, addresses, and occupations of the persons who have ceased to be members since the last list was made, and the number of shares held by each of them.

The above list and summary shall be contained in a separate part of the register, and shall be completed within seven days after such fourteenth day as is mentioned in this section, and a copy shall forthwith be forwarded to the Registrar of Joint Stock Companies.

Register of Mortgages.

43.—Every limited company under this Act shall keep a register of all mortgages and charges specifically affecting property of the company, and shall enter in such register in respect of each mortgage or charge a short description of the property mortgaged or charged, the

amount of charge created, and the names of the mortgagees or persons entitled to such charge: If any property of the company is mortgaged or charged without such entry as aforesaid being made, every director, manager, or other officer of the company who knowingly and wilfully authorises or permits the omission of such entry shall incur a penalty not exceeding fifty pounds: The register of mortgages required by this section shall be open to inspection by any creditor or member of the company at all reasonable times; and if such inspection is refused, any officer of the company refusing the same, and every director and manager of the company authorising or knowingly and wilfully permitting such refusal, shall incur a penalty not exceeding five pounds, and a further penalty not exceeding two pounds for every day during which such refusal continues; and in addition to the above penalty, as respects companies registered in *England* and *Ireland*, any Judge sitting in chambers, or the Vice-Warden of the Stannaries in the case of companies subject to his jurisdiction, may by order compel an immediate inspection of the register.

Certain Companies to publish Statement entered in Schedule.

44.—Every limited banking company and every insurance company, and deposit, provident, or benefit society under this Act, shall, before it commences business, and also on the first *Monday* in *February* and the first *Monday* in *August* in every year during which it carries on business, make a statement in the form marked D in the first schedule hereto, or as near thereto as circumstances will admit, and a copy of such statement shall be put up in a conspicuous place in the registered office of the company, and in every branch office or place where the business of the company is carried on, and if default is made in compliance with the provisions of this section the company shall be liable to a penalty not exceeding five pounds for every day during which such default continues, and every director and manager of the company who shall knowingly and wilfully authorise or permit such default shall incur the like penalty.

Every member and every creditor of any company mentioned in this section shall be entitled to a copy of the above-mentioned statement on payment of a sum not exceeding sixpence.

List of Directors to be sent to Registrar.

45.—Every company under this Act, and not having a capital divided into shares, shall keep at its registered office a register containing the names and addresses and occupations of its directors or managers, and shall send to the Registrar of Joint Stock Companies a copy of such register, and shall, from time to time, notify to the registrar any change that takes place in such directors or managers.

FIRST SCHEDULE.

TABLE A.

Accounts.

78.—The directors shall cause true accounts to be kept of the stock-in-trade of the company, of the sums of money received and expended by the company, and the matter in respect of which such receipts and expenditure takes place; and of the liabilities and credits of the company. The books of account shall be kept at the registered office of the company, and, subject to any reasonable restrictions as to the time and manner of inspecting the same that may be imposed by the company in general meeting, shall be open to the inspection of the members during the hours of business.

79.—Once at least in every year the directors shall lay before the company, in general meeting, a statement of the income and expenditure for the past year, made up to a date not more than three months before such meeting.

80.—The statement so made shall show, arranged under the most convenient heads, the amount of gross income, distinguishing the several sources from which it has been derived; and the amount of gross expenditure, distinguishing the expense of the establishment, salaries, and other like matters. Every item of expenditure fairly chargeable against the year's income shall be brought into account, so that a just balance of profit and loss may be laid before the meeting; and in cases where any item of expenditure which may in fairness be distributed over several years has been incurred in any one year, the whole amount of such item shall be stated, with the addition of the reasons why only a portion of such expenditure is charged against the income of the year.

81.—A Balance Sheet shall be made out in every year, and laid before the company in general meeting, and such Balance Sheet shall contain a summary of the property and liabilities of the company arranged under the heads appearing in the form annexed to this table, or as near thereto as circumstances admit.

82.—A printed copy of such Balance Sheet shall, seven days previously to such meeting, be served on every member, in the manner in which notices are hereinafter directed to be served.

Audit.

83.—Once at least in every year the accounts of the company shall be examined, and the correctness of the Balance Sheet ascertained, by one or more auditor or auditors.

84.—The first auditors shall be appointed by the directors. Subsequent auditors shall be appointed by the company in general meeting.

85.—If one auditor only is appointed all the provisions herein contained relating to auditors shall apply to him.

86.—The auditors may be members of the company ; but no person is eligible as an auditor who is interested otherwise than as a member in any transaction of the company ; and no director or other officer of the company is eligible during his continuance in office.

87.—The election of auditors shall be made by the company at their ordinary meeting in each year.

88.—The remuneration of the first auditors shall be fixed by the directors ; that of subsequent auditors shall be fixed by the company in general meeting.

89.—Any auditor shall be re-eligible on his quitting office.

90.—If any casual vacancy occurs in the office of any auditor appointed by the company, the directors shall forthwith call an extraordinary general meeting for the purpose of supplying the same.

91.—If no election of auditors is made in manner aforesaid, the Board of Trade may, on the application of not less than five members of the company, appoint an auditor for the current year, and fix the remuneration to be paid to him by the company for his services.

92.—Every auditor shall be supplied with a copy of the Balance Sheet, and it shall be his duty to examine the same, with the accounts and vouchers relating thereto.

93.—Every auditor shall have a list delivered to him of all books kept by the company, and shall at all reasonable times have access to the books and accounts of the company. He may, at the expense of the company, employ accountants or other persons to assist him in investigating such accounts, and he may in relation to such accounts examine the directors or any other officer of the company.

94.—The auditors shall make a report to the members upon the Balance Sheet and accounts, and in every such report they shall state whether, in their opinion, the Balance Sheet is a full and fair Balance Sheet, containing the particulars required by these regulations, and properly drawn up so as to exhibit a true and correct view of the state of the company's affairs : and in case they have called for explanations or information from the directors, whether such explanations or information have been given by the directors, and whether they have been satisfactory : and such report shall be read, together with the report of the directors, at the ordinary meeting.

Dr.	BALANCE SHEET of the	Co., made up to	18	Cr.
CAPITAL AND LIABILITIES.		PROPERTY AND ASSETS.		
I. CAPITAL.	<p>Showing:</p> <p>1. The number of shares £ s d</p> <p>2. The amount paid per share £ s d</p> <p>3. If any arrears of calls, the nature of the arrears, and the names of the defaulters. .</p> <p>4. The particulars of any forfeited shares ..</p>			
II. DEBTS AND LIABILITIES of the Company	<p>Showing:</p> <p>5. The amount of loans on mortgages or debenture bonds, £ s d</p> <p>6. The amount of debts owing by the Company, distinguishing</p> <p>(a)</p> <p>(b)</p> <p>(c)</p> <p>(d)</p> <p>(e) other loans</p> <p>(f) Unclaimed dividends</p> <p>(g) Debts not enumerated above ..</p>			
VI. RESERVE FUND.	<p>Showing:</p> <p>The amount set aside from profits to meet contingencies £ s d</p>			
VII. PROFIT & Loss.	<p>Showing:</p> <p>The disposable balance for payment of dividends, &c. £ s d</p>			
CONTINGENT LIABILITIES	<p>Claims against the Company not acknowledged as debts £ s d</p> <p>Moneys for which the Company is contingently liable £ s d</p>			

FORM D.

FORM OF STATEMENT referred to in Part III. of the Act.

*The capital of the company is , divided into
shares of each

The number of shares issued is

Calls to the amount of pounds per share have been made,
under which the sum of pounds has been received.

The liabilities of the company on the 1st day of January (or July)
were,—

Debts owing to sundry persons by the company.

On judgment, £
On specialty, £
On notes or bills, £
On simple contracts, £
On estimated liabilities, £

The assets of the company on that day were,—

Government securities [*stating them*], £
Bills of exchange and promissory notes, £
Cash at the bankers, £
Other securities, £

* If the company has no capital divided into shares, the portion of the statement relating to capital and shares must be omitted.

THE COMPANIES ACT 1879.

42 and 43 Vict. c. 76.

4.—Subject as in this Act mentioned, any company registered before or after the passing of this Act as an unlimited company may register under the Companies Acts 1862 to 1879, as a limited company, or any company already registered as a limited company may re-register under the provisions of this Act.

Audit of Accounts of Banking Companies.

7.—(1) Once at least in every year the accounts of every banking company registered after the passing of this Act as a limited company shall be examined by an auditor or auditors, who shall be elected annually by the company in general meeting.

(2) A director or officer of the company shall not be capable of being elected auditor of such company.

(3) An auditor on quitting office shall be re-eligible.

(4) If any casual vacancy occurs in the office of any auditor, the surviving auditor or auditors (if any) may act, but if there is no surviving auditor, the directors shall forthwith call an extraordinary general meeting for the purpose of supplying the vacancy or vacancies in the auditorship.

(5) Every auditor shall have a list delivered to him of all books kept by the company, and shall at all reasonable times have access to the books and accounts of the company; and any auditor may, in relation to such books and accounts, examine the directors or any other officer of the company: Provided that if a banking company has branch banks beyond the limits of Europe, it shall be sufficient if the auditor is allowed access to such copies of and extracts from the books and accounts of any such branch as may have been transmitted to the head office of the banking company in the United Kingdom.

Report of Auditors.

(6) The auditor or auditors shall make a report to the members on the accounts examined by him or them, and on every Balance Sheet laid before the company in general meeting during his or their tenure of office; and in every such report shall state whether, in his or their opinion, the Balance Sheet referred to in the report is a full and fair Balance Sheet properly drawn up, so as to exhibit a true and correct view of the state of the company's affairs, as shown by the books of the company; and such report shall be read before the company in general meeting.

(7) The remuneration of the auditor or auditors shall be fixed by the general meeting appointing such auditor or auditors, and shall be paid by the company.

8.—Every Balance Sheet submitted to the annual or other meeting of the members of every banking company registered after the passing of this Act as a limited company shall be signed by the auditor or auditors, and by the secretary or manager (if any), and by the directors of the company, or three of such directors at the least.

PARLIAMENTARY COMPANIES.**THE COMPANIES CLAUSES CONSOLIDATION
ACT 1845.***8 Vict. c. 16.**Register of Shareholders.*

9.—The company shall keep a book to be called the “Register of Shareholders,” and in such book shall be fairly and distinctly entered, from time to time, the names of the several corporations, and the names and addresses of the several persons entitled to shares in the company, together with the number of shares to which such shareholders shall be respectively entitled, distinguishing each share by its number and the amount of the subscriptions paid on such shares, and the surnames or corporate names of the said shareholders shall be placed in alphabetical order; and such book shall be authenticated by the common seal of the company being affixed thereto; and such authentication shall take place at the first ordinary meeting, or at the next subsequent meeting of the company, and so from time to time at each ordinary meeting of the company.

Addresses of Shareholders.

10.—In addition to the said Register of Shareholders, the company shall provide a book to be called the “Shareholders’ Address Book,” in which the secretary shall, from time to time, enter in alphabetical order the corporate names and places of business of the several shareholders of the company, being corporations, and the surnames of the several other shareholders, with their respective Christian names, places of abode, and descriptions, so far as the same shall be known to the company.

Register of Mortgages and Bonds.

45.—A register of mortgages and bonds shall be kept by the secretary, and within fourteen days after the date of any such mortgage or bond an entry or memorial, specifying the number and date of such mortgage or bond and the sums secured thereby, and the names of the parties thereto, with their proper additions, shall be made in such register.

Register of Stock.

63.—The company shall, from time to time, cause the names of the several parties who may be interested in any such stock as aforesaid, with the amount of the interest therein possessed by them respectively, to be entered in a book to be kept for the purpose, and to be called “The Register of Holders of Consolidated Stock.”

Election of Auditors.

101.—Except where, by the special Act, auditors shall be directed to be appointed otherwise than by the company, the company shall, at the first ordinary meeting after the passing of the special Act, elect the prescribed number of auditors, and, if no number is prescribed, two auditors, in like manner as is provided for the election of directors; and at the first ordinary meeting of the company in each year thereafter the company shall in like manner elect an auditor to supply the place of the auditor then retiring from office, according to the provision hereinafter contained; and every auditor elected as hereinbefore provided, being neither removed nor disqualified nor having resigned, shall continue to be an auditor until another be elected in his stead.

102.—Where no other qualification shall be prescribed by the special Act, every auditor shall have at least one share in the undertaking; and he shall not hold any office in the company, nor be in any other manner interested in its concerns except as a shareholder.

103.—One of such auditors (to be determined in the first instance by ballot between themselves, unless they shall otherwise agree, and afterwards by seniority) shall go out of office at the first ordinary meeting in each year; but the auditor so going out shall be immediately re-eligible, and after any such re-election shall, with respect to the going out of office by rotation, be deemed a new auditor.

104.—If any vacancy take place among the auditors in the course of the current year, then, at any general meeting of the company, the vacancy may, if the company think fit, be supplied by election of the shareholders.

105.—The provision of this Act respecting the failure of an ordinary meeting at which directors ought to be chosen shall apply, *mutatis mutandis*, to any ordinary meeting at which an auditor ought to be appointed.

Powers and Duties of Auditors.

106.—The directors shall deliver to such auditors the half-yearly or other periodical accounts and Balance Sheet fourteen days at the least before the ensuing ordinary meeting at which the same are required to be produced to the shareholders, as hereinafter provided.

107.—It shall be the duty of such auditors to receive from the directors the half-yearly or other periodical accounts and Balance Sheet required to be presented to the shareholders, and to examine the same.

108.—It shall be lawful for the auditors to employ such accountants and other persons as they may think proper, at the expense of the company, and they shall either make a special report on the said accounts

or simply confirm the same ; and such report or confirmation shall be read, together with the report of the directors, at the ordinary meeting.

Accounts.

115.—The directors shall cause full and true accounts to be kept of all sums of money received or expended on account of the company by the directors and all persons employed by or under them, and of the matters and things for which such sums of money shall have been received or disbursed and paid.

116.—The books of the company shall be balanced at the prescribed periods, and, if no periods be prescribed, fourteen days at least before each ordinary meeting ; and, forthwith, on the books being so balanced, an exact Balance Sheet shall be made up, which shall exhibit a true statement of the capital, stock, credits, and property of every description belonging to the company, and the debts due by the company at the date of making such Balance Sheet, and a distinct view of the profit or loss which shall have arisen on the transactions of the company in the course of the preceding half-year ; and previously to each ordinary meeting such Balance Sheet shall be examined by the directors, or any three of their number, and shall be signed by the chairman or deputy-chairman of the directors.

118.—The directors shall produce to the shareholders assembled at such ordinary meeting the said Balance Sheet, applicable to the period immediately preceding such meeting, together with the report of the auditors thereon, as hereinbefore provided.

Dividends.

120.—Previously to every ordinary meeting at which a dividend is intended to be declared, the directors shall cause a scheme to be prepared showing the profits, if any, of the company for the period current since the preceding ordinary meeting at which a dividend was declared, and apportioning the same, or so much thereof as they may consider applicable to the purposes of dividend, among the shareholders, according to the shares held by them respectively, the amount paid thereon, and the periods during which the same may have been paid, and shall exhibit such scheme at such ordinary meeting, and at such meeting a dividend may be declared according to such scheme.

121.—The company shall not make any dividend whereby their capital stock will be in any degree reduced : provided always that the word “dividend” shall not be construed to apply to a return of any portion of the capital stock, with the consent of all the mortgagees and bond creditors of the company, due notice being given for that purpose at an extraordinary meeting to be convened for that object.

122.—Before apportioning the profits to be divided among the shareholders the directors may, if they think fit, set aside thereout such sum as they may think proper to meet contingencies, or for enlarging, repairing, or improving the works connected with the undertaking, or any part thereof, and may divide the balance only among the shareholders.

123.—No dividend shall be paid in respect of any share, until all calls then due in respect of that and every other share held by the person to whom such dividend may be payable shall have been paid.

MINING COMPANIES.

THE STANNARIES ACT 1887.

50 and 51 Vict. c. 43.

Interpretation.

2.—In this Act—

The term “the Stannaries” means the Stannaries of Cornwall and Devon :

The term “Vice-Warden” means the Vice-Warden of the Stannaries for the time being :

“Court” means the Vice-Warden’s court :

The “registrar” means the registrar for the time being of the Court :

25 and 26 Vict. c. 89.

The term “company” means any persons or partnership body, joint stock company, company constituted under the Companies Act 1862, or any statutory modification thereof, and whether corporate or unincorporate, and whether limited or unlimited, engaged in or formed for working mines within the Stannaries :

The term “purser” means the purser for the time being of a company, or if there is no purser then the secretary for the time being, or if there is no secretary, then the principal agent or manager for the time being of a company :

The term “Cost Book” includes all books and papers relating to the business of a mine which are for the time being kept by a purser, or which, according to law or the custom of the Stannaries, ought to be kept by him :

The term "lessors" means the lessor or grantor of any lease, or grant of any mine, or licence to exercise mining rights and powers, and includes every person entitled under any such lease, grant, or licence, or any other instrument whatever, to receive the rents or dues payable in respect of any mine :

The term "mortgagees" includes all holders of mortgage-debentures, mortgages, or other charges issued by any company :

The term "sheriff" includes any officer charged with the execution of a writ or other process :

The term "miners" includes all artisans, labourers, and other persons working in and about a mine, except the purser, secretary, agent, or manager :

The term "wages" includes all earnings by miners arising from any description of piece or other work, or as tributers or otherwise :

The term "mining effects" includes machinery, materials, goods, and chattels, and all ores and halvans, and all other personal property appertaining to a mine, or used or intended to be used for mining purposes.

Extent of Act.

3.—This Act extends only to metalliferous mines and tin streaming works within the Stannaries.

Mine club funds to be accounted for.

13.—(1) After the commencement of this Act, any custom or rule of law to the contrary notwithstanding, all moneys deducted in any mine from the wages or earnings of or otherwise contributed by the miners for the purposes of a mine club, or accident, or sick or benefit fund, shall, unless a majority of the miners shall by resolution decide otherwise, be deemed to belong to the miners and not to the company, and the said moneys, and any contributions added thereto by the shareholders, shall be placed to a separate account, and the details thereof, showing the amount received and the several payments thereout, and to whom made during each preceding sixteen weeks, shall be set out in the Balance Sheet to be presented to the shareholders at each ordinary meeting ; and a copy of the same shall be posted in the miners' dry or changing sheds, and in the account house ; and it shall be lawful for the miners in any mine, if they so please, to appoint any two of themselves to audit the said mine club fund accounts : Provided that section thirty-four of this Act shall not restrain the right of the miners to pass any such resolution, and such resolution shall have effect for twelve calendar months only after the passing thereof. And in the event of any money being so deducted for the purpose of medical attendance,

each miner shall be entitled to name a qualified medical practitioner to whom the amount so deducted from his wages shall be paid for such medical attendance.

(2) Upon the winding-up of any company in the Court of the Vice-Warden or any other Court, or otherwise, the said mine club moneys or fund shall not be deemed to be or be applied as part of the assets of the company in liquidation of the debts of the company or otherwise; but shall be accounted for by the purser or any other person in possession of the fund to the liquidator, and shall be recoverable by him, and shall be applied in accordance with the rules of the club. Where a company is being wound up voluntarily, the liquidator, or any person claiming to be entitled to any such moneys or fund, may apply to the Court for directions or to determine any question arising in the matter, in the same manner as if the company were being wound up by the Court.

Power to pay over club funds to registered friendly society.

14.—When deductions are made from the wages of miners for the maintenance of a mine club fund, under the provisions of the last preceding section of this Act, it shall be lawful for the miners employed in or about the mine by resolution of a majority of such miners to appoint a committee of management of such fund: Provided that if any portion of the said fund is contributed by the company, the sanction and concurrence of the said company shall be required in respect of the appointment of such committee; and such committee may transfer the same to any registered friendly society, established for the whole or any part of the Stannaries district, and willing to receive the same upon such terms as may be agreed upon between the said committee and the said society.

Mortgages of mining plant and effects to be registered.

19.—All mortgages, mortgage debentures, and other documents whatever, whereby power is given by any company to any persons to take possession of any mining effects of or on a mine, shall, in addition to any registration thereof now required by law, be registered within twenty-eight days from the date thereof, at the office of the said registrar, in a book to be kept there for that purpose, without payment of any fee, and such book shall be subject to the inspection of all applicants at all reasonable times, and no such mortgage, mortgage debenture, or other document, unless so registered, shall confer any priority over or title as against the claims of any persons whatever for work and labour done or services performed in or upon such mine, or for goods and materials supplied to any company by which the said mine is carried on; such registration shall not affect any priority in respect of wages under the provisions of this Act.

Copy of all mining grants to be filed.

20.—A true copy of all leases, grants, and licences made after the commencement of this Act, giving to the grantee the right to work mineral property within the said Stannaries, and also of all assignments and contracts for the sale of such leases, grants, and licences, shall be filed by the lessee, grantee, licencee, assignee, or purchaser thereof at the said office of the said registrar within fourteen days from the execution thereof; and in default of such filing thereof, no such lease, grant, licence, assignment, or contract shall, until filed, be enforceable at law or in equity.

Valuation of relinquished shares.

21.—When, after the commencement of this Act, a share in a company has been relinquished, and a valuation of the materials and other assets of the company is required to be made as between the shareholder who has relinquished and the continuing shareholders, such valuation shall be made upon the basis that all the said continuing shareholders had also at the same time relinquished their shares.

Relinquishment not valid unless delivered six weeks before stoppage of mine.

22.—After the commencement of this Act a relinquishment shall not have any effect if it be delivered within the six weeks immediately preceding the day on which a resolution to wind up the company shall be legally passed at a duly convened meeting of the company, or on which an order shall be made to wind up the same by or subject to the supervision of the Court.

Accounts to be entered in Cost Book.

23.—The purser of every Cost Book mine shall, once at least every sixteen weeks, truly enter in the Cost Book of the mine accounts showing the actual financial position of the company at the end either of the financial month of such company last preceding the time of entry, or of the calendar month last preceding that time, including a statement of all credits, debts, and liabilities, and distinguishing in such accounts the amounts of calls paid, and calls not paid, and also all other accounts, documents, and things that the purser is required to enter therein by the custom of the Stannaries, or by the direction of the company, and if any purser shall fail to make such entries or any of them within the time or in manner above directed, he shall, when and so often as he shall so fail, be liable to a penalty not exceeding twenty pounds, to be recovered in a summary manner before any two or more justices of the peace.

Penalty for false entries, &c.

24.—If in the said accounts any false statement or entry shall be made, or any material particular omitted with the knowledge of the purser, the said purser shall be liable in respect of every such false statement, entry, or omission to a penalty not exceeding fifty pounds, to be recovered in a summary manner before any two or more justices of the peace, and the said justices may, in their absolute discretion, award any portion of the penalty imposed by them (not exceeding one moiety thereof) to the prosecutor, provided he is a shareholder in the company or a person having a legal right to inspect the said accounts; if such false statement, entry or material particular has been made or omitted with the knowledge of the manager of the mine, such manager shall also be liable to a like penalty, to be recovered in like manner and with the like discretion in the justices as to their apportionment thereof.

Meetings to be held once every sixteen weeks.

25.—The purser of every Cost Book mine shall duly convene an ordinary meeting of the shareholders in such mine at least once every sixteen weeks, for the transaction of the ordinary business of the said mine, and at every such meeting the Cost Book of the said mine, containing the accounts and other matters required by this Act to be entered therein, together with a list showing the name and address of every shareholder from whom any call is in arrear and unpaid, and the amount of the calls unpaid by him, shall be laid before the meeting, and be open to full and unrestricted inspection by any shareholder present, and if any purser shall fail to convene such meeting, or to duly hold the same, or shall fail to produce the said Cost Book thereat, or to permit it to be inspected as aforesaid, he shall forfeit for each and every such default a sum not exceeding ten pounds, to be recovered in a summary manner on the complaint of any shareholder in the company, before any two or more justices of the peace.

Accounts to be printed.

26.—The accounts by the twenty-third section of this Act directed to be entered in the Cost Book shall, after the same have been laid before a meeting of the shareholders in pursuance of the twenty-fifth section, be printed, and a copy thereof sent to each shareholder in the company and also to the lessors of the mine.

Evasions of this Act to be void.

34.—Any contract expressed or implied with the employers, or terms of hiring, which would in effect deprive miners of any right secured

to them by this Act, or impose any condition whatever in reference to the disposition of club or benefit funds, shall, so far as such rights are affected, and in respect of any such condition, be void and of no effect.

Printed copies of this Act to be posted up.

35.—Printed copies of this Act, and of the rules and regulations for the time being in force in any mine, shall be kept posted up in the smiths' shop and in the miners' dry or changing shed of every mine.

THE STANNARIES COURT (ABOLITION) ACT 1896.

59 and 60 Vict. c. 45.

An Act for abolishing the Court of the Vice-Warden of the Stannaries.

BE it enacted by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same as follows:—

1.—(1) On the commencement of this Act, the Court of the Vice-Warden of the Stannaries shall cease to exist except for the purpose of continuing and concluding proceedings pending in that Court at that date, and as from that date all jurisdiction and powers of the said Court and its officers shall, except as aforesaid, be transferred to and vested in such of the County Courts as the Lord Chancellor may by order direct, and be exercised subject to and in accordance with rules of Court for regulating the procedure in County Courts.

(2) Provision may be made by order of the Lord Chancellor:—

(a) for determining by, to, or before what officer, or in what office, may be done anything required to be done by, to, or before any officer or in any office of the said Court of the Vice-Warden;

(b) for transferring to a County Court any proceedings pending in the said Court at the commencement of this Act;

(c) for determining the place of sitting for the exercise of any jurisdiction transferred by this Act;

(d) with respect to the use and disposal of any property which at the commencement of this Act is held for the use of the said Court or of any officer of the said Court, and of any room or building which at that date is appropriated for the use of the said Court or of the Vice-Warden, officers, and suitors thereof; and

(e) with respect to the custody of any records which at that date are under the custody of the said Court.

2.—There shall be paid to the persons who are at the commencement of this Act the Vice-Warden and officers of the Court of the Vice-Warden of the Stannaries such pensions, and on such conditions, and out of such funds (including the funds mentioned in section 29 of the Stannaries Act 1887, and any other funds available for the purpose), as may be fixed by the Treasury with the concurrence of His Royal Highness the Prince of Wales and Duke of Cornwall, regard being had to the date and form of appointment, and salary attached thereto, and to the nature and length of the services of those persons and to the amount and nature of the funds available for their pensions.

3.—References in any unrepealed enactment to mines subject to the jurisdiction of the Court of the Vice-Warden of the Stannaries, or within the cognizance of the said Vice-Warden, shall be construed as applying to mines which would have been subject to the jurisdiction of the said Court if it had not been abolished.

4.—(1) In the event of any dispute arising between :—

(a) any two or more mining companies ; or

(b) any mining company and any person having any estate or interest in the mine worked by or leased to that mining company ;

a Judge of a County Court exercising the jurisdiction of the Stannaries Court may, on the application of any party to the dispute, order that the matter in dispute be tried before himself or before an arbitrator agreed on by the parties or an officer of the Court, and the Arbitration Act 1889 shall apply to any such reference.

(2) For the purposes of this section the expression “ mining company ” shall mean any person or body of persons engaged in or formed for working mines within the Stannaries.

5.—The enactments described in the schedule to this Act are hereby repealed to the extent mentioned in the third column of that schedule.

Provided that nothing in this repeal shall affect any proceedings pending in the Court of the Vice-Warden of the Stannaries at the commencement of this Act, or any appeal from the said Court pending at that date.

6.—This Act shall come into operation on the first day of January one thousand eight hundred and ninety-seven.

7.—This Act may be cited as the Stannaries Court (Abolition) Act 1896.

SCHEDULE.

ENACTMENTS REPEALED.

Session and Chapter	Title or Short Title	Extent of Repeal
16 Chas. 1. c. 15	An Act against diverse Incroachments and Oppressions in the Stannaries Courts	The whole Act
6 & 7 Will. 4. c. 106	The Stannaries Act 1836	The whole Act except sections four, six, and seven
7 & 8 Vict. c. 65	An Act to enable the Council of His Royal Highness Albert Edward, Prince of Wales, to sell and exchange lands and enfranchise copyholds, parcel of the possessions of the Duchy of Cornwall, to purchase other lands, and for other purposes	Section forty
2 & 3 Vict. c. 5	An Act to make further provision for the administration of justice and for improving the practice and proceedings in the Courts of the Stannaries of Cornwall, and for the prevention of frauds by workmen employed in mines within the county of Cornwall	The whole Act
11 & 12 Vict. c. 83	An Act to confirm the Awards of Assessionable Manors Commissioners, and for other purposes relating to the Duchies of Cornwall and Lancaster	Sections seven to eleven, and section thirteen
18 & 19 Vict. c. 32	An Act to amend and extend the jurisdiction of the Stannaries Court	The whole Act, except sections one and thirty-one
25 & 26 Vict. c. 89	The Companies Act 1862	Section eighty-three, from "and the vice-warden" to the end of this section, sections one hundred and eight, and one hundred and sixteen, section one hundred and twenty-four from "Provided" to the end of the section, and section one hundred and seventy-two
32 & 33 Vict. c. 19	The Stannaries Act 1869	Sections twenty-seven to thirty-three, and thirty-eight to forty-four
50 & 51 Vict. c. 43	The Stannaries Act 1887	Sections eight, twenty-eight, thirty, thirty-two, and thirty-three

INSURANCE COMPANIES.**THE LIFE ASSURANCE COMPANIES ACT 1870.***33 and 34 Vict. c. 61.**Life funds separate.*

4.—In the case of a company established after the passing of this Act, transacting other business besides that of Life Assurance, a separate account shall be kept of all receipts in respect of the life assurance and annuity contracts of the company, and the said receipts shall be carried to and for a separate fund to be called the Life Assurance Fund of the company, and such fund shall be as absolutely the security of the life policy and annuity holders as though it belonged to a company carrying on no other business than that of Life Assurance, and shall not be liable for any contracts of the company for which it would not have been liable had the business of the company been only that of Life Assurance; and in respect to all existing companies, the exemption of the Life Assurance Fund from liability for other obligations than to its life policy holders shall have reference only to the contracts entered into after the passing of this Act, unless by the constitution of the company such exemption already exists: Provided always, that this section shall not apply to any contracts made by any existing company by the terms of whose deed of settlement the whole of the profits of all the business are paid exclusively to the life policy holders, and on the face of which contracts the liability of the assured distinctly appears.

Statements to be made by companies.

5.—From and after the passing of this Act every company shall, at the expiration of each financial year of such company, prepare a statement of its Revenue Account for such year, and of its Balance Sheet at the close of such year, in the forms respectively contained in the first and second schedules to this Act.

Statements by company doing other than life business.

6.—Every company which, concurrently with the granting of policies of assurance or annuities on human life, transacts any other kind of assurance or other business shall, at the expiration of each such financial year as aforesaid, prepare statements of its Revenue Account for such year, and of its Balance Sheet at the close of such year, in the forms respectively contained in the third and fourth schedules of this Act.

Actuarial report and abstract.

7.—Every company shall, once in every five years if established after the passing of this Act, and once every ten years if established before the passing of this Act, or at such shorter intervals as may be prescribed by the instrument constituting the company, or by its regulations or bye-laws, cause an investigation to be made into its financial condition by an actuary, and shall cause an abstract of the report of such actuary to be made in the form prescribed in the fifth schedule to this Act.

Statement of life and annuity business.

8.—Every company shall, on or before the thirty-first day of December, one thousand eight hundred and seventy-two, and thereafter within nine months after the date of each such investigation as aforesaid into its financial condition, prepare a statement of its life assurance and annuity business in the form contained in the sixth schedule of this Act, each of such statements to be made up as at the date of the last investigation, whether such investigation be made previously or subsequently to the passing of this Act: Provided as follows:—

(1) If the next financial investigation, after the passing of this Act, of any company fall during the year one thousand eight hundred and seventy-three, the said statement of such company shall be prepared within nine months after the date of such investigation, instead of on or before the thirty-first day of December, one thousand eight hundred and seventy-two.

(2) If such investigation be made annually by any company, such company may prepare such statement at any time, so that it be made at least once in every three years.

The expression “date of each such investigation” in this section shall mean the date to which the accounts of each company are made up for the purposes of each such investigation.

Forms may be altered.

9.—The Board of Trade, upon the applications of or with the consent of a company, may alter the forms contained in the schedules to this Act, for the purpose of adapting them to the circumstances of such company, or of better carrying into effect the objects of this Act.

Statements, etc., to be signed and printed and deposited with Board of Trade.

10.—Every statement or abstract hereinbefore required to be made shall be signed by the chairman and two directors of the company and by the principal officer managing the life assurance business, and, if the company has a managing director, by such managing director, and shall be printed; and the original, so signed as aforesaid, together with three printed copies thereof, shall be deposited at the Board of Trade within nine months of the dates respectively hereinbefore prescribed as the dates at which the same are to be prepared. And every annual statement so deposited after the next investigation shall be accompanied by a printed copy of the abstract required to be made by section seven.

Copies of statements to be given to Shareholders, etc.

11.—A printed copy of the last deposited statement, abstract, or other document by this Act required to be printed, shall be forwarded by the company by post or otherwise, on application, to every shareholder and policy-holder of the company.

FORM OF ANNUAL ACCOUNTS PRESCRIBED BY LIFE
ASSURANCE COMPANIES ACT 1870.

FIRST SCHEDULE.

REVENUE ACCOUNT of the			for the year ending 18 .		
18 (Date)	Amount of Funds at the beginning of the year.. Premiums Consideration for Annuities granted .. Interest and Dividends.. Other Receipts (Accounts to be specified).. ..	£ s d	18 (Date)	Claims under Policies (after deduction of Sums re-assured) .. Surrenders Annuities Commission Expenses of Management Dividends and Bonuses to Shareholders (if any) Other Payments (Accounts to be specified) Amount of Funds at the end of the year as per Second Schedule ..	£ s d
	£			£	

Note 1.—Companies having separate Accounts for Annuities to return the particulars of their Annuity business in a separate statement.

Note 2.—Items in this and in the Accounts in the Third and Fifth Schedules should be the net amounts after deduction of the amounts paid and received in respect of re-assurances.

FIFTH SCHEDULE.

STATEMENT RESPECTING THE VALUATION OF THE LIABILITIES UNDER
LIFE POLICIES AND ANNUITIES of the , to be made
by the Actuary.

(The answers should be numbered to accord with the numbers of the
corresponding questions.)

1. The date up to which the valuation is made.
2. The principles upon which the valuation and distribution of profits among the policy-holders are made, and whether these principles were determined by the instrument constituting the company, or by its regulations or bye-laws or otherwise.
3. The table or tables of mortality used in the valuation.
4. The rate or rates of interest assumed in the calculations.
5. The proportion of the annual premium income (if any) reserved as a provision for future expenses and profits. (If none, state how this provision is made.)
6. The Consolidated Revenue Account since the last valuation, or in case of a company which has made no valuation, since the commencement of the business. (This return should be made in the form annexed.)
7. The liabilities of the company under life policies and annuities at the date of the valuation, showing the number of policies, the amount assured, and the amount of premiums payable annually under each class of policies, both with and without participation in profits; and also the net liabilities and assets of the company, with the amount of surplus or deficiency. (These returns should be made in the form annexed.)
8. The time during which a policy must be in force in order to entitle it to share in the profits.
9. The results of the valuation, showing :—
 - (1) The total amount of profit made by the company.
 - (2) The amount of profit divided among the policy-holders, and the number and amount of the policies which participated.
 - (3) Specimens of bonuses allotted to policies for £100 effected at the respective ages of 20, 30, 40, and 50, and having been respectively in force for five years, ten years, and upwards, at intervals of five years respectively, together with the amounts apportioned under the various modes in which the bonus might be received.

The term "extra premium" in this Act shall be taken to mean the charge for any risk not provided for in the minimum contract premium. If policies are issued in or for any country at rates of premium deduced from tables other than the European Mortality Tables adopted by the company, separate schedules similar in form to the above must be furnished.

(FORM referred to under heading No. 7, in Fifth Schedule.)

VALUATION BALANCE SHEET of		as at	18 .
Dr.			Cr.
To Net Liability under Assurance and Annuity Transactions (as per Summary Statement provided in Schedule 5)	£	By Life Assurance and Annuity Funds (as per Balance Sheet, under Schedule 2 or 4)	£
Surplus (if any)		" Deficiency (if any)	
	£		£

SIXTH SCHEDULE.

STATEMENT OF THE LIFE ASSURANCE AND ANNUITY BUSINESS of
the on the 18 .

(The answers should be numbered to accord with the number of the corresponding questions. Statements of re-assurances corresponding to the statements in respect of assurances under headings 2, 3, 4, 5, and 6, are to be given.)

1. The published table or tables of premiums for assurances for the whole term of life which are in use at the date above mentioned.

2. The total amount assured on lives for the whole term of life, which are in existence at the date above mentioned, distinguishing the portions assured with and without profits, stating separately the total reversionary bonuses, and specifying the sums assured for each year of life from the youngest to the oldest ages.

3. The amount of premiums receivable annually for each year of life, after deducting the abatements made by the application of bonuses, in respect of the respective assurances mentioned under heading No. 2, distinguishing ordinary from extra premiums.

4. The total amount assured under classes of assurance business other than for the whole term of life, distinguishing the sums assured under each class, and stating separately the amount assured with and without profits, and the total amount of reversionary bonuses.

5. The amount of premiums receivable annually in respect of each such special class of assurances mentioned under heading No. 4, distinguishing ordinary from extra premiums.

6. The total amount of premiums which has been received from the commencement upon all policies under each special class mentioned under heading No. 4, which are in force at the date above mentioned.

7. The total amount of immediate annuities on lives, distinguishing the amounts for each year of life.

8. The amount of all annuities other than those specified under heading No. 7, distinguishing the amount of annuities payable under each class, the amount of premiums annually receivable, and the amount of consideration money received in respect of each such class, and the total amount of premiums received from the commencement upon all deferred annuities.

9. The average rate of interest at which the life assurance fund of the company was invested at the close of each year during the period since the last investigation.

10. A table of minimum values (if any) allowed for the surrender of policies for the whole term of life, and for endowments and endowment assurances, or a statement of the method pursued in calculating such surrender values, with instances of its application to policies of different standing, and taken out at various interval ages from the youngest to the oldest.

Separate statements to be furnished for business at other than European rates, together with a statement of the manner in which policies on unhealthy lives are dealt with.

GAS ACCOUNTS.

THE GAS WORKS CLAUSES ACT 1847.

10 and 11 Vict. c. 15.

30.—The profits of the undertaking to be divided amongst the undertakers in any year shall not exceed the prescribed rate, or where no rate is prescribed they shall not exceed the rate of ten pounds in the hundred by the year on the paid-up capital in the undertaking, which in such case shall be deemed the prescribed rate, unless a larger dividend be at any time necessary to make up the deficiency of any previous dividend which shall have fallen short of the said yearly rate.

31.—If the clear profits of the undertaking in any year amount to a larger sum than is sufficient, after making up the deficiency in the dividends of any previous year as aforesaid, to make a dividend at the

prescribed rate, the excess beyond the sum necessary for such purpose shall from time to time be invested in Government or other securities; and the dividends and interest arising from such securities shall also be invested in the same or like securities, in order that the same may accumulate at compound interest until the fund so formed amounts to the prescribed sum, or if no sum be prescribed a sum equal to one-tenth of the nominal capital of the undertakers, which sum shall form a reserved fund to answer any deficiency which may at any time happen in the amount of divisible profits, or to meet any extraordinary claim or demand which may at any time arise against the undertakers; and if such fund be at any time reduced it may thereafter be again restored to the said sum, and so from time to time as often as such reduction shall happen.

32.—Provided always that no sum of money shall be taken from the said fund for the purpose of meeting any extraordinary claim, unless it be first certified in England or Ireland by two justices, and in Scotland by the sheriff, that the sum so proposed to be taken is required for the purpose of meeting an extraordinary claim within the meaning of this or the special Act.

33.—When such fund shall, by accumulation or otherwise, amount to the prescribed sum, or one-tenth of the nominal capital of the company, as the case may be, the interest and dividends thereon shall no longer be invested, but shall be applied to any of the general purposes of the undertaking to which the profits thereof are applicable.

34.—If in any year the profits of the undertaking divisible among the undertakers shall not amount to the prescribed rate, such a sum may be taken from the Reserve Fund as with the actual divisible profits of such year will enable the undertakers to make a dividend of the amount aforesaid, and so from time to time as often as the occasion shall require.

35.—In England or Ireland the Court of Quarter Sessions, and in Scotland the sheriff, may, on the petition of any two gas ratepayers, within the limits of the special Acts, nominate and appoint some accountant or other competent person, not being a proprietor of any gas-works, to examine and ascertain at the expense of the undertakers (the amount of such expense to be determined by the said court or sheriff) the actual state and condition of the concerns of the undertakers, and to make report thereof to the said court at the then present or some following sessions, or to the sheriff; and the said court or sheriff may examine any witnesses upon oath touching the truth of the said accounts, and matters therein referred to; and if it thereupon appear to the said court or sheriff that the profits of the undertakers

for the preceding year have exceeded the prescribed rate, the undertakers *shall*, in case the whole of the said reserved fund has been, and then remains, invested as aforesaid, and in case dividends to the amount hereinbefore limited have been paid, make such a rateable deduction in the rate for gas to be furnished by them as in the judgment of the said court or sheriff shall be proper, but as such rates, when reduced, shall ensure to the undertakers (regard being had to the amount of profit before received) a profit as near as may be to the prescribed rate.

36.—Provided always, that if, in the case of any petition so presented, it appear to the said court or sheriff that there was no sufficient ground for presenting the same, the said court or sheriff may, if they or he think fit, order the petitioner to pay the whole or any part of the costs of, or incident to, such petition (the amount thereof to be determined by the said court or sheriff), and the costs so ordered to be paid shall be recoverable in the same way as damages are recoverable under this or the special Act.

37.—If the undertakers shall, for seven days after being required to produce to the said court or sheriff, or to the said accountant or other person as aforesaid, any books of account or other books, bills, receipts, vouchers, or papers, relating to the pecuniary affairs of the undertakers, refuse or neglect to produce such books, bills, receipts, vouchers, or papers, they shall forfeit the sum of one hundred pounds for every such refusal or wilful neglect, and the further sum of ten pounds for every day such refusal or wilful neglect shall continue after the expiration of the said seven days, such respective penalties to be recovered by any person who will sue for the same, with full costs of suit in any of the superior courts.

38.—With respect to the yearly receipts and expenditure of the undertakers, be it enacted, that the undertakers shall, in each year after they have begun to supply gas under the provisions of this or the special Act, cause an account in abstract to be prepared of the total receipts and expenditure of all rents or funds levied under the powers of this or the special Act for the year preceding, under the several distinct heads of receipt and expenditure, with a statement of the balance of such account, duly audited and certified by the chairman of the undertakers, and also by the auditors thereof, if any; and a copy of such annual account if the gas-works be situated in England or Ireland, shall be transmitted, free of charge, to the clerk of the peace for the county in which the gas-works are situate, and if the gas-works be situated in Scotland, such copies shall be transmitted, free of charge, to the sheriff clerk of such county, and such transmission shall be made on or before the 31st day of January in each year, under a penalty of £20

for each default; and the copy of such account so sent to the said clerk of the peace or sheriff clerk shall be kept by him, and shall be open to inspection by all persons at all reasonable hours, on payment of one shilling for each inspection.

THE GAS WORKS CLAUSES ACT 1871.

34 and 35 Vict. c. 41.

35.—The undertakers shall fill up and forward to the local authority of every district within the limits of the special Act, on or before the twenty-fifth day of March in each year, an annual statement of accounts made up to the thirty-first day of December then next preceding, as near as may be in the form and containing the particulars specified in Schedule B. to this Act annexed.

The undertakers shall keep copies of such annual statement at their office, and sell the same to any applicant at a price not exceeding one shilling for each such copy.

The Board of Trade, with the consent of the undertakers, may alter the said forms for the purpose of adapting them to the conveniences of the undertaking, or of better carrying into effect the objects of this section.

SCHEDULE B.
Form of Annual Accounts.
The Gas Company.

Year ending 31st December 18 .
A.—STATEMENT OF SHARE CAPITAL, on the 31st December 18 .

1	2	3	4	5	6	7	8	9
Description of Capital	Maximum Dividend authorised	Number of Shares issued	Nominal Amount of Share	Called up per Share	Total paid up	Amount issued but not paid up	Remaining to be issued	Total Amounts authorised
	£ s d		£ s d	£ s d	£ s d	£ s d	£ s d	£ s d

B.—STATEMENT OF LOAN CAPITAL, on the 31st December 18 .

1	2	3	4	5
Description of Loan (Mortgage, Bond, Debenture, Stock, &c.)	Rate per cent. of Interest	Total Amounts borrowed at 31st December 18 .	Remaining to be borrowed	Total Amounts authorised
		£ s d	£ s d	£ s d

Total Share Capital paid up (see A.) £
" Loan " borrowed (see B.) £
Total Capital received £

Dr. E.—PROFIT AND LOSS ACCOUNT (NET REVENUE) for the year ended 31st December 18 Cr.

	£	s	d	£	s	d
1. To Amount carried to Reserve Fund Account, F. (if any) from profits of 18	1. By Balance of net profit brought from last account (31st Dec. 18)	..	..
2. " Interest on temporary loans, and moneys received in anticipation of calls	2. " Amount drawn from reserved fund (if any)	..	..
3. " Ditto on mortgages and bonds accrued to 31st Dec. 18	Less Dividend paid for the half-year ended 31st Dec. 18	..	..
4. " Ditto on debenture stock to ditto	3. " Balance brought from Revenue Account, D., being profit for year to Dec. 18	..	..
5. " Half-year's dividend on 1st preferential to 30th June 18	4. " Interest on moneys deposited	..	..
6. " Ditto, 2nd preferential to ditto			
7. " Ditto, on ordinary shares at per cent.			
" Balance of net profit to be carried to next account subject to half-year's dividends to 31st Dec. 18			
						£

F.—RESERVED FUND ACCOUNT, for the year ended 31st December 18

	£	s	d	£	s	d
1. Amount (if any) carried to Profit and Loss Account, E., to make up deficiencies of dividends to 31st Dec. 18	1. By Balance brought from last Account	..	..
2. Amount paid for extraordinary claim or demand (if any)	2. " Balance brought from Profit and Loss Account, E.	..	..
3. Amount of balance to be carried to next Account	3. " Interest on amount invested	..	..
						£

Like Accounts must be given for Depreciation Fund for works on leaseholds (if any).

WATER ACCOUNTS.**THE WATERWORKS CLAUSES ACT 1847.**

10 and 11 Vict. c. 17.

Profits of the company to be limited.

75.—The profits of the undertaking to be divided among the undertakers in any year shall not exceed the prescribed rate, or where no rate is prescribed they shall not exceed the rate of ten pounds in the hundred by the year on the paid-up capital in the undertaking, which in such case shall be deemed the prescribed rate, unless a larger dividend be at any time necessary to make up the deficiency of any previous dividend which shall have fallen short of the said yearly rate.

If profits exceed the amount limited, excess to be invested and form a reserved fund.

76.—If the clear profits of the undertaking in any year amount to a larger sum than is sufficient, after making up the deficiency in the dividends of any previous year as aforesaid, to make a dividend at the prescribed rate, the excess beyond the sum necessary for such purpose shall from time to time be invested in Government or other securities, and the dividends and interest arising from such securities shall also be invested in the same or like securities, in order that the same may accumulate at compound interest until the fund so formed amounts to the prescribed sum, or if no sum be prescribed to a sum equal to one-tenth part of the nominal capital of the undertakers, which sum shall form a reserved fund to answer any deficiency which may at any time happen in the amount of divisible profits, or to meet any extraordinary claim or demand which may at any time arise against the undertakers; and if such fund be at any time reduced it may thereafter be again restored to the said sum, and so from time to time as often as such reduction shall happen.

Reserved fund not to be resorted to unless to meet an extraordinary claim.

77.—Provided always that no sum of money shall be taken from the said fund for the purpose of meeting any extraordinary claim, unless it be first certified, in *England* or *Ireland*, by two justices, and in *Scotland* by the sheriff, that the sum so proposed to be taken is required for the purpose of meeting any extraordinary claim within the meaning of this or the special Act.

When fund amounts to prescribed sum, interest to be applied to purposes of the undertaking.

78.—When such fund shall, by accumulation or otherwise, amount to the prescribed sum, or one-tenth part of the nominal capital, as the case may be, the interest and dividends thereon shall no longer be invested, but shall be applied to any of the general purposes of the undertaking to which the profits thereof are applicable.

If profits are less than the prescribed rate, a sum may be taken from reserved fund to supply deficiency.

79.—If in any year the profits of the undertaking divisible amongst the undertakers shall not amount to the prescribed rate, such a sum may be taken from the reserved fund as, with the actual divisible profits of such year, will enable the undertakers to make a dividend of the amount aforesaid, and so from time to time as often as the occasion shall require.

Annual Account to be made up by undertakers, and sent to the Clerk of the Peace in England or Ireland, or to the Sheriff Clerk in Scotland, and to be open to inspection.

83.—And with respect to the yearly receipt and expenditure of the undertakers, be it enacted, that the undertakers shall, in each year after they have begun to supply water under this or the special Act, cause an account in abstract to be prepared of the whole receipt and expenditure of all rates or other moneys levied under the powers of this or the special Act for the year preceding, under the several distinct heads of receipt and expenditure, with a statement of the balance of such Account, duly audited and certified by the chairman of the undertakers, and also by the auditors thereof, if any; and a copy of such annual account shall be sent, free of charge, to the clerk of the peace for the county in which the waterworks are situated, if the waterworks are situated in *England* or *Ireland*, and if the waterworks are situated in *Scotland*, to the sheriff clerk of such county, on or before the thirty-first day of *January* in each year, under a penalty of twenty pounds for each default; and the copy of such account so sent to the said clerk shall be kept by him, and shall be open to inspection by all persons, at all seasonable hours, on payment of one shilling for each inspection.

THE METROPOLIS WATER ACT 1871.

*34 and 35 Vict. c. 113.**Accounts, etc.*

37.—Every company shall, on or before the thirty-first day of July in each year, fill up and forward to the Board of Trade, and to the town clerk of the City of London, and to the Metropolitan Board of Works, and to the vestry clerk of each parish within which water is supplied by each company respectively not within the City of London, a statement of accounts, made up to the end of their financial year then last past, in such form and containing such particulars as may from time to time be prescribed by the Board of Trade.

Each company shall keep copies of such statement at their office for one year after the date thereof, and sell the same to any applicant at a price not exceeding one shilling for each such copy.

In case any company make default in complying with any of the provisions of this section, they shall be liable to a penalty not exceeding ten pounds for each day during which such default continues.

Auditor of Accounts.

38.—There shall be an auditor of the accounts of the companies, being a competent and impartial person, from time to time appointed by and removable by the Board of Trade.

There shall be paid to such auditor such remuneration by the companies and in such proportions as such Board appoints.

Ascertainment of capital of companies.

39.—The auditor shall, with all practicable speed after the passing of this Act, investigate the accounts of the companies, and ascertain and certify the amounts of their capitals, distinguishing share from loan capital, and shall ascertain and certify the capital of each company, and shall from time to time, as new capital shall be expended, in like manner ascertain and certify the amount of such new capital that has been *bond fide* expended for the purposes of the undertaking. Notwithstanding anything in this Act, the auditor shall not investigate the accounts of any company antecedent to the date mentioned in that behalf in relation to such company in the Schedule C to this Act annexed.

Periodical audit of accounts.

40.—The auditor shall once in every half-year audit the accounts of the companies.

If he finds the accounts correct he shall certify the same, but if in any instance he finds the accounts of any company incorrect in principle or in detail, he shall require such company to correct such accounts in such manner as he thinks right, and no future dividend shall in any case be declared by any company until their accounts are certified by the auditor; provided that the suspension of a dividend under this section shall not operate until after the expiration of nine months from the date of the audit.

Facilities for auditor.

41.—Each company shall, during, as well as subsequent to the close of, that half-year to which the accounts relate, give to the auditor, his clerks and assistants, access to the books and documents of such company, and shall, when required, furnish to him and them all vouchers and information requisite for the purposes of the audit, and shall afford to him and them all facilities for the proper execution of his and their duty; and any company making default in complying with any of the provisions of this section shall, for every such default, be liable to a penalty not exceeding ten pounds.

Arbitration between auditor and company.

- 42.—If any company think themselves aggrieved by any act or determination of the auditor, the matter in difference shall be referred to the determination of an arbitrator agreed on between such company and the auditor, or, in default of agreement, appointed, on the application of either party, by the Lord Chief Justice of the Court of Common Pleas; and the reference shall be subject and according to the provisions of the Common Law Procedure Act 1854; and the decision of the arbitrator shall be final and conclusive; and, subject to this provision, such company shall observe and abide by the directions and determinations of the auditor.

ELECTRIC LIGHTING ACCOUNTS.

ELECTRIC LIGHTING ACTS 1882 TO 1890.
Form of Accounts prescribed by the Board of Trade for an Electric Lighting Company.
..... ELECTRIC LIGHTING ORDER (LICENCE).
THE COMPANY.
Year ending 31st December 18 .

STATEMENT OF SHARE CAPITAL APPROPRIATED FOR THE PURPOSES OF THE UNDERTAKING
AUTHORISED BY THE ABOVE-MENTIONED ORDER (LICENCE).

No. I.

On the 31st December 18 .

Description of Capital	Authorised by	Number of Shares Issued	Nominal Amount of Share	Called-up per Share	Total Paid-up	Issued not Paid-up	Remaining un-issued	Total Amount Authorised

Dr.

REVENUE ACCOUNT

Cr.

No. IV. for the year ending 31st December 18 .

		£	s	d	£	s	d	£	s	d
<i>A.—To Generation of Electricity.</i>										
1.	To Coals or other fuel, including dues, carriage, unloading, storing, and all expenses of placing the same on the works	..	..	..			
2.	"	..	..	..			
3.	"	..	..	..			
4.	"	..	..	..			
5.	"	..	..	..			
					£ s d					
1.	Buildings	..	..	..			
2.	Engines, boilers	..	..	..			
3.	Dynamos, exciters, transformers, motors, &c.	..	..	..			
4.	Other machinery, instruments, and tools	..	..	..			
5.	Accumulators and accessories	..	..	..			
					£ s d					

Dr.		REVENUE ACCOUNT—cont.		Cr.	
No. IV cont.		£ s d	£ s d	£ s d	£ s d
	Brought over .. ..	..	..	..	..
	D.—To Royalties, &c.				
	To Royalties, &c., payable for use of patents or patent processes .. ..	..	..	..	..
	E.—To Rents, Rates, and Taxes.				
	1. To Rents payable .. ..	..	..	..	..
	2. To Rates and taxes .. ..	..	..	..	..
	F.—To Management Expenses.				
	1. To				
	2. To				
	3. To				
	4. To				
	5. To				
	6. To				
	7. To				
	Carried forward .. ..	..	..	..	..
	Brought over .. ..	..	..	..	..
	Carried forward .. ..	..	..	..	..

Dr.		REVENUE ACCOUNT—cont.				Cr.	
No. IV.—cont.							
		£	s	d	£	s	d
	Brought over						
	G.—To Law and Parliamentary Charges.						
	To Law Expenses						
	H.—To Depreciation.						
	1. To Depreciation in respect of Leasehold Works ..						
	2. " Do. Buildings ..						
	3. " Do. Plant, Machinery, &c. ..						
	I.—To Special Charges.						
	1. To Insurance, Superannuation, &c. ..						
	2. " Expenses for Certification of Meters ..						
	Total Expenditure						
	Balance carried to Net Revenue						

NET REVENUE ACCOUNT.		Cr.	
Dr.			
No. V.			
1. To Interest on Debentures accrued due to date	£ s d	1. By Balance from last Account	£ s d
2. " Interest on Mortgages and Bonds accrued due to date		Less Dividend paid	
3. " Interest on		" Amount carried to Reserve Fund	
4. " Dividend			
5. " Balance a		2. By Balance brought from Revenue Account	
		(No. IV.)	
		3. " Interest on Money at Deposit	
			£

RESERVE FUND ACCOUNT.		Cr.	
Dr.			
No. VI.			
1. Amount paid out for	£ s d	1. By Balance brought from last Account	£ s d
2. Amount of Balance to next Account		2. " Amount brought from Net Revenue Account	
		3. " Interest on Amount Invested	
		(Description of Investments to be specified)	
	£		£

DEPRECIATION FUND ACCOUNT.		Cr.	
Dr.			
No. VII.			
1. To Balance	£ s d	1. By Balance from last Account	£ s d
		2. " Interest on Investments	
		3. " Amount brought from Revenue Account (see No. IV. H.)	
		(Description of Investments to be specified)	
	£		£

STATEMENT OF ELECTRICITY GENERATED, SOLD, &C.

[illegible]

ELECTRIC LIGHTING CLAUSES ACT 1899.

62 and 63 Vict. c. 19.

1.—The provisions contained in the schedule to this Act shall be incorporated with and form part of every provisional order made by the Board of Trade after the commencement of this Act under the Electric Lighting Acts, save so far as they are expressly varied or excepted by the order, and shall, subject to any such variations or exceptions, apply, so far as applicable, to the undertaking authorised by the order. The said provisions shall also, with the necessary modifications, and, in particular, with the substitution of the words “special Act” for “special order” be incorporated with any special Act, save so far as they are expressly varied or excepted thereby. . . . The expression “special Act” means in this Act, any Act passed after the commencement of this Act authorising the supply of electricity for any public or private purposes within any area.

2.—(2) Except so far as any of the provisions contained in the schedule to this Act are incorporated with any provisional order made by the Board of Trade under the Electric Lighting Acts extending to the county of London, or with any special Acts so extending, this Act shall not apply to the county of London.

6.—The following provisions shall apply as to the audit of accounts where the undertakers are not a local authority : —

(1) The annual statement of accounts of the undertaking, before being published as provided by section nine of the Electric Lighting Act 1882 shall be examined and audited by such competent and impartial person as the Board of Trade appoint, and the remuneration of the auditor shall be such as the Board of Trade direct, and that remuneration and all expenses incurred by him in or about the execution of his duties, to such an amount as the Board of Trade approve, shall be paid by the undertakers on demand, and shall be recoverable summarily as a civil debt.

(2) The undertakers shall give to the auditor, his clerks and assistants, access to such of the books and documents relating to the undertaking as are necessary for the purposes of the audit, and shall when required furnish to him and them all vouchers and information requisite for that purpose, and shall afford to him and them all facilities for the proper execution of his and their duty.

(3) The Board of Trade may make and vary regulations prescribing the times at and the mode in which the audit shall be made and conducted, or otherwise for the purpose of giving effect to the provisions of this section.

(4) Any report made by the auditor, or such portion thereof as the Board of Trade direct, shall be appended to the annual statement of accounts, and shall form part thereof for the purposes of the said section nine.

RAILWAY ACCOUNTS.

THE RAILWAY COMPANIES SECURITIES ACT 1866.

29 and 30 Vict. c. 108.

2.—In this Act the term “railway” includes a tramway authorised by Act of Parliament incorporating the Companies Clauses Consolidation Act 1845, but not any other tramway ;

The term “railway company” includes every company authorised by Act of Parliament to raise any loan capital for the construction or working of a railway, or for any purposes connected with the conveyance by such a company of traffic on a railway either alone or in conjunction with other purposes ;

The term “debenture stock” includes mortgage preference stock and funded debt and any stock or shares representing loan capital of a railway company, by whatever name called.

4.—Half-years shall, for the purpose of this Act, be deemed to end on the thirtieth day of June and the thirty-first day of December ; and the first half-year to which this Act applies shall be that ending on the thirty-first day of December one thousand eight hundred and sixty-six ; but the Board of Trade, on the application of any railway company, may (by writing under the hand of one of their secretaries or assistant secretaries, which shall be registered by the railway company at the office of the said Registrar) appoint, with respect to that company, other days for the ending of half-years (including the first).

5.—Within fourteen days after the end of each half-year every railway shall make an account of their loan capital authorised to be raised and actually raised up to the end of that half-year, specifying the particulars described in the first schedule to this Act, Part 1 (which account for each half-year is in this Act referred to as the loan capital half-yearly account).

6.—The Board of Trade may, from time to time, by notice published in the London, Edinburgh, and Dublin *Gazettes*, prescribe the form in which the loan capital half-yearly account is to be made.

THE FIRST SCHEDULE.

PART I.—PARTICULARS TO BE SPECIFIED IN LOAN CAPITAL
HALF-YEARLY ACCOUNT.

A.—Every half-yearly account to show—

(1) The Act or Acts of Parliament under the powers of which the company have contracted any mortgage or bond debt existing at the end of the half-year, or have issued any debenture stock then existing, or the Act or Acts of Parliament by or under which any mortgage or bond debt or debenture stock of the company then existing has been confirmed, and the Act or Acts of Parliament under which the company have any subsisting power to contract any mortgage or bond debt, or to issue any debenture stock (either on fulfilment of any condition or otherwise).

(2) The amount or respective amounts of mortgage or bond debt or debenture stock thereby authorised or confirmed.

(3) Whether or not by any such Act or Acts the obtaining of the certificate of a justice or sheriff for any purpose, or the obtaining of the assent of a meeting of the company, has been made a condition precedent to the exercise of the power thereby conferred of borrowing on mortgage or bond, or of creating and issuing debenture stock.

(4) The date at which such condition has been fulfilled.

(5) The amount or the aggregate amount under the powers of such Act or Acts actually borrowed up to the end of the half-year on mortgage or bond (distinguishing them), and then being an existing debt, and of debenture stock actually issued up to that time and then existing.

(6) The amount or the aggregate amount remaining to be borrowed.

B.—The second and every subsequent half-yearly account to show also—

(7) The items described in paragraphs (2) and (5) of this part of the present schedule for two consecutive half-years, and the increase or decrease of any of these items in the second of those half-years as compared with the first.

THE RAILWAY COMPANIES ACT 1867.

*30 and 31 Vict. c. 127.**Audit of Railway Accounts.*

30.—No dividend shall be declared by a company until the auditors have certified that the half-yearly accounts proposed to be issued contain a full and true statement of the financial condition of the company, and that the dividend proposed to be declared on any shares is *bond fide* due thereon after charging the revenue of the half-year with all expenses which ought to be paid thereout in the judgment of the auditors; but if the directors differ from the judgment of the auditors with respect to the payment of any such expenses out of the revenue of the half-year, such difference shall, if the directors desire it, be stated in the report to the shareholders, and the company in general meeting may decide thereon, subject to all the provisions of the law then existing, and such decisions shall for the purpose of the dividend be final and binding; but if no such difference is stated, or if no such decision is given on any such difference, the judgment of the auditors shall be final and binding; and the auditors may examine the books of the company at all reasonable times, and may call for such further accounts, and such vouchers, papers, and information as they think fit, and the directors and officers of the company shall produce and give the same as far as they can, and the auditors may refuse to certify as aforesaid until they have received the same; and the auditors may at any time add to their certificate, or issue to the shareholders independently at the cost of the company, any statement respecting the financial condition and prospects of the company which they think material for the information of the shareholders.

THE REGULATION OF RAILWAYS ACT 1868.

*31 and 32 Vict. c. 119.**Uniform accounts, etc., to be kept.*

3.—Every incorporated company, seven days at least before each ordinary half-yearly meeting held after the thirty-first day of *December* one thousand eight hundred and sixty-eight, shall prepare and print, according to the forms contained in the first schedule to this Act, a statement of accounts and Balance Sheet for the last preceding half-year, and the other statements and certificates required by the same schedule, and an estimate of the proposed expenditure out of capital

for the next ensuing half-year, and such statement of accounts and Balance Sheet shall be the statement of accounts and Balance Sheet which are submitted to the auditors of the company. Every company which makes default in complying with this section shall be liable to a penalty not exceeding five pounds for every day during which such default continues. The Board of Trade with the consent of a company, may alter the said forms as regards such company for the purpose of adapting them to the circumstances of such company, or of better carrying into effect the objects of this section.

Accounts, etc., to be signed, and printed copies distributed.

4.—Every statement of accounts, Balance Sheet, and estimate of expenditure, prepared as required by this Act, shall be signed by the chairman or deputy-chairman of the directors and by the accountant or other officer in charge of the accounts of the company, and shall be preserved at the company's principal office. A printed copy thereof shall be forwarded to the Board of Trade.

Penalty for falsifying accounts, etc.

5.—If any statement, Balance Sheet, estimate or report which is required by this Act, is false in any particular to the knowledge of any person who signs the same, such person shall be liable, on conviction thereof on indictment, to fine and imprisonment, or on summary conviction thereof to a penalty not exceeding fifty pounds.

Auditor not necessarily a shareholder.

11.—Whenever, after the passing of this Act, section one hundred and two of the Companies Clauses Consolidation Act 1845 is incorporated in a certificate or special Act relating to a railway company, it shall be construed as if the words, "where no qualification shall be prescribed by the special Act every auditor shall have at least one share in the undertaking," were omitted therefrom; and so much of every certificate and special Act relating to a railway company, and in force at the passing of this Act, as incorporates that portion of the said section, and so much of any special Act relating to a railway company, and so in force as contains a like provision, is hereby repealed.

Auditors of company, and appointment of auditor by Board of Trade.

12.—With respect to the auditors of the company the following provision shall have effect:—

(1) The Board of Trade may, upon application made in pursuance of a resolution passed at a meeting of the directors or at a general

meeting of the company, appoint an auditor in addition to the auditors of such company, and it shall not be necessary for any such auditor to be a shareholder in the company ;

(2) The company shall pay to such auditor appointed by the Board of Trade such reasonable remuneration as the Board of Trade may prescribe ;

(3) The auditor so appointed shall have the same duties and powers as the auditors of the company, and shall report to the company ;

(4) Where, in consequence of such appointment of an auditor or otherwise, there are three or more auditors, the company may declare a dividend if the majority of such auditors certify in manner required by section 30 of the Railway Companies Act 1867, and the Railway Companies (*Scotland*) Act 1867, respectively ;

(5) Where there is a difference of opinion among such auditors, the auditor who so differs shall issue to the shareholders, at the cost of the company, such statement respecting the grounds on which he differs from his colleagues, and respecting the financial condition and prospects of the company, as he thinks material for the information of the shareholders.

Issue of preferred and deferred ordinary stock.

13.—Any company which, in the year immediately preceding, has paid a dividend on their ordinary stock of not less than three pounds *per centum per annum* may, pursuant to the resolution of an extraordinary general meeting, divide their paid-up ordinary stock into two classes, to be and to be called, the one preferred ordinary stock, and the other deferred ordinary stock, and issue the same subject and according to the following provisions, and with the following consequences (that is to say) :—

(1) Preferred and deferred ordinary stock shall be issued only in substitution for equal amounts of paid-up ordinary stock, and by way of division of portions of ordinary stock into two equal parts ;

(6) As between preferred ordinary stock and deferred ordinary stock, preferred ordinary stock shall bear a fixed maximum dividend at the rate of six *per centum per annum* ;

(7) In respect of dividend to the extent of the maximum aforesaid, preferred ordinary stock shall at the time of its creation, and at all times afterwards, have priority over deferred ordinary stock created or to be created, and shall rank *pari passu* with the undivided ordinary stock and the ordinary shares of the company created or to be created ; and in respect of dividend, preferred ordinary stock shall at all times and to all intents rank after all preference and guaranteed stock and shares of the company created or to be created ;

(8) In each year after all holders of preferred ordinary stock for the time being issued have received in full the maximum dividend aforesaid, all holders of deferred ordinary stock for the time being issued shall, in respect of all dividend exceeding that maximum paid by the company in that year on ordinary stock and shares, rank *pari passu* with the holders of undivided ordinary stock and of ordinary shares of the company for the time being issued ;

(9) If, nevertheless, in any year ending on the thirty-first day of *December*, there are not profits available for payment to all the holders of preferred ordinary stock of the maximum dividend aforesaid, no part of the deficiency shall be made good out of the profits of any subsequent year, or out of any other funds of the company.

Extension of scope of Railway Companies Powers Act 1864.

38.—The Railway Companies Powers Act 1864 shall take effect and apply in the following cases in the same manner as if they were specified in section three of that Act (that is to say) :

Where a company desire to make new provisions, or to alter any of the provisions of their special Act, or of the Companies Clauses Consolidation Act 1845, so far as it is incorporated therewith, with respect to all or any of the matters following ; namely

(e) The appointment and duties of auditors.

SCHEDULE I.

FORMS OF ACCOUNT PRESCRIBED BY REGULATION OF
RAILWAYS ACT, 1868.

RAILWAY. Half-year ending 18 .

[No. 1.] STATEMENT OF CAPITAL AUTHORISED, AND CREATED BY THE
COMPANY.

ACTS OF PARLIAMENT or Certificates of the Board of Trade	CAPITAL AUTHORISED			CAPITAL CREATED OR SANCTIONED			BALANCE		
	Stock and Shares	Loans	Total	Stock and Shares	Loans	Total	Stock and Shares	Loans	Total
1. { [Except where capital powers 2. { are comprised in a Consolida- 3. { tion Act, each Act or Certificate 4. { authorising Capital to be stated 5. { here separately in order of &c. { date.]	£	£	£	£	£	£	£	£	£
Total									

[No. 2.] STATEMENT OF STOCK AND SHARE CAPITAL CREATED, SHOWING
THE PROPORTION RECEIVED.

DESCRIPTION	Amount created	Amount received	Calls in arrears	Amount uncalled	Amount unissued
[State each class of Stock or Shares in order of date of creation, showing the premium or discount, if any, at which it was issued, the preferential or fixed dividends, if any, to which it is entitled, and any other con- ditions attached to it.]	£	£	£	£	£
Total					

[No. 7.] ESTIMATE OF FURTHER EXPENDITURE OF CAPITAL ACCOUNT.

	FURTHER EXPENDITURE.		
	During the Half-Year ending	In subsequent Half-Years	Total
Lines open for traffic			
(Particulars showing principal items)			
Lines in course of construction			
(Details of each line)			
Working Stock			
(Particulars)			
Subscription to other Railways			
(Specifying Lines)			
Docks, Steamboats, and other special items.. .. .			
(Particulars)			
Works not yet commenced and in abeyance (in detail)			
Other items (in detail)			
Total estimated further Expenditure of Capital			

[No. 8.] CAPITAL POWERS AND OTHER ASSETS AVAILABLE TO MEET FURTHER EXPENDITURE, as per No. 7.

Share and Loan Capital authorised or created, but not yet received ..		
Any other Assets (in detail)		
Total		

[No. 9.] *Dr.* REVENUE ACCOUNT. *Cr.*

Half-Year ended	EXPENDITURE	£ s d	Half-Year ended	RECEIPTS	£ s d	£ s d
	To Maintenance of Way, Works and Stations			By Passengers		
	„ Locomotive Power			„ Parcels, Horses, Carriages, etc.		
	„ Carriage & Waggon Repairs			„ Mails		
	„ Traffic Expenses			„ Merchandise		
	„ General Charges			„ Live Stock		
	„ Law Charges			„ Minerals		
	„ Parliamentary Expenses			„ Special and Miscellaneous Receipts—		
	„ Compensation (Accidents and Losses)			Such as		
	„ Rates and Taxes			Navigation		
	„ Government Duty			Steamboats		
	„ Special and Miscellaneous Expenses (if any)			Rents		
				Transfer Fees, &c.		
	„ Balance carried to Net Revenue Account			Details		
	£			£		

[No. 10.] *Dr.* NET REVENUE ACCOUNT. *Cr.*

Half-Year ended		£ s d	Half-Year ended		£ s d
	To Interest on Mortgage and Debenture Loans			By Balance brought from last Half-year's Account	
	• Interest on Debenture Stock			• Ditto Revenue Account, No. 9.	
	• Interest on Calls in advance			• Dividends on Shares in other Companies	
	• Interest on Temporary Loans			• Bankers and General Interest Account (if in credit)	
	• Interest on Lloyd's Bonds			• Special and Miscellaneous Receipts (if any)	
	• Interest on Banking Balances				
	• General Interest Account (if in debit)			(Detail to be given.)	
	• Rents of Leased Lines, Guarantees, &c.				
	• Details.				
	• Special and Miscellaneous Payments (if any)				
	• Details.				
	• Balance, being Payment available for dividend				
	[See No. 13.] £				£

[No. 11.]

PROPOSED APPROPRIATION OF BALANCE AVAILABLE FOR DIVIDEND.

Half-Year ended	Balance available for Dividend as per Account No 10	£
	Preference Stock { to be stated in order of creation, } £	
	Ditto { with rate of dividend }	
	Ditto	
	Ordinary Stock (being at the rate of per cent.)	
	Balance to next Half-year	£

[No. 12.]

ABSTRACTS.

A. MAINTENANCE OF WAY, WORKS, &c.				C. REPAIRS AND RENEWALS OF CARRIAGES AND WAGGONS.			
Half-Year ended		£ s d	£ s d	Half-Year ended		£ s d	£ s d
	Salaries, Office Expenses and General Superintendence				CARRIAGES:		
	Maintenance and Renewal of Permanent Way				Salaries, Office Expenses and General Superintendence ..		
	Wages				Wages		
	Materials				Materials		
					WAGGONS:		
	Repairs of Roads, Bridges, Signals, and Works ..				Salaries, Office Expenses and General Superintendence ..		
	Repairs of Stations and Buildings ..				Wages		
	Special Expenditure (if any)				Materials		
					Total		
	MILES MAINTAINED:						
	Double ..						
	Single ..						
	Total ..						
	Total ..						
B. LOCOMOTIVE POWER.				D. TRAFFIC EXPENSES.			
Half-Year ended		£ s d	£ s d	Half-Year ended		£ s d	£ s d
	Salaries, Office Expenses and General Superintendence				Salaries and Wages, &c. ..		
					Fuel, Lighting, Water, and General Stores.. ..		
	RUNNING EXPENSES:				Clothing, Printing, Stationery, and Tickets		
	Wages connected with the working of Locomotive Engines ..				Horses, Harness, Vans, Provender, &c.		
	Coal and Coke				Waggon Covers, Ropes, &c. ..		
	Water				Joint Station Expenses.. ..		
	Oil, Tallow, and other Stores				Miscellaneous Expenses ..		
					Special Expenditure (if any) ..		
	REPAIRS AND RENEWALS:						
	Wages						
	Materials						
	Special Expenditure ..						
	£						
				E. GENERAL CHARGES.			
Half-Year ended				Half-Year ended		£ s d	£ s d
					Directors		
					Auditors and Public Accountants (if any)		
					Salaries of Secretary, General Manager, Accountant, and Clerks		
					Office Expenses ditto ditto		
					Advertising		
					Fire Insurance		
					Electric Telegraph Expenses..		
					Railway Clearing House Expenses		
					Special Expenditure (if any) ..		

[No. 13.] *Dr.* GENERAL BALANCE SHEET. *Cr.*

	£	s	d		£	s	d
To Capital Account, balance at credit thereof, as per Account No. 4				By Cash at Bankers—Current Account			
" Net Revenue Account, Balance at Credit thereof, as per Account No. 10				" Cash on Deposit at Interest			
" Unpaid Dividends and Interest				" Cash invested in Consols and Government Securities			
" Guaranteed Dividends and Interest payable or accruing and provided for				" Cash invested in Shares of other Railway Companies not charged as Capital Expenditure			
" Temporary Loans				" General Stores—Stock of materials on hand			
" Lloyd's Bond and other obligations not included in Loan Capital Statement, No. 3				" Traffic Accounts due to the Company			
" Balance due to Bankers				" Amounts due by other Companies			
" Debts due to other Companies				" Do. Clearing House			
" Amount due to Clearing House				" Do. Post Office			
" Sundry Outstanding Accounts				" Sundry Outstanding Accounts			
" Fire Insurance Fund on Stations, Works, and Buildings				" Suspense Accounts (if any)			
" Insurance Fund on Steamboats				<i>To be enumerated.</i>			
" Special Items				" Special Items			
	£				£		

[No. 14.] MILEAGE STATEMENT.

Half-Year ended		Miles authorised	Miles constructed	Miles constructing or to be constructed	Miles worked by Engines
	Lines owned by Company				
	Do. partly owned				
	Do. leased or rented				
	Total				
	Do. worked				
	Foreign lines worked over				
	Total				

[No. 15.] STATEMENT OF TRAIN MILEAGE.

Half-Year ended					
	Passenger Trains .. ..	..	..	..	..
	Goods and Mineral Trains .. ..	..	..	..	..
	Total .. ..	..	..	..	..

(Signed)

Chairman or Deputy-Chairman of Company.
Secretary or Accountant of Company.

I hereby certify that the whole of the Company's Permanent Way, Stations, Buildings, Canals, and other Works, have during the past half-year been maintained in good working condition and repair.

Date 18 *Engineer.*

I hereby certify that the whole of the Company's Plant, Engines, Tenders, Carriages, Wagons, Machinery, and Tools, also the Marine Engines of the Steam Vessels, have during the past half-year been maintained in good working order and repair.

Date 18. } Chief Engineer or
Locomotive Superintendent.

(As prescribed by Act 30 and 31 Victoria, cap. 127, sec. 30.)

CORPORATION ACCOUNTS.

THE PUBLIC HEALTH ACT 1875.

38 and 39 Vict. c. 55.

Officers entrusted with money to give security.

194.—Before any officer or servant of a local authority enters on any office or employment under this Act by reason whereof he will or may be entrusted with the custody or control of money, the local authority by whom he is appointed shall take from him sufficient security for the faithful execution of such office or employment, and for duly accounting for all moneys which may be entrusted to him by reason thereof.

Officers to account.

195.—Every officer and servant appointed or employed under this Act by a local authority shall, when and in such manner as may be required by such authority, make out and deliver to them a true and perfect account in writing of all moneys received by him for the purposes of this Act, stating how, and to whom, and for what purpose such moneys have been disposed of, and shall, together with such account, deliver the vouchers or receipts for all payments made by him, and pay over to the treasurer all moneys owing by him on the balance of accounts.

And every such officer or servant employed in the collection of any rate made under this Act shall, within seven days after he has received any moneys on account of any such rate, pay over the same to the treasurer, and shall, as and when the local authority may direct, deliver a list signed by him and containing the names of all persons who have neglected or refused to pay any such rate, and the sums respectively due from them.

Summary of proceedings against defaulting officers.

196.—If any officer or servant appointed or employed under this Act by a local authority—

Fails to render accounts, or to produce and deliver up vouchers and receipts, or to pay over any moneys, as and when required by this Act, or

Fails within five days after written notice in that behalf from the local authority to deliver up to the local authority all books, papers, writings, property and things, in his possession or power, relating to the execution of this Act, or belonging to such authority,

the local authority may complain to any justice, and such justice shall thereupon summon the party charged to appear before a Court of summary jurisdiction.

On the appearance of the party charged, or on proof that the summons was personally served on him, or left at his last known place of abode or business, if it appears to the Court that he has failed to render any such accounts, or to pay over such moneys, or to produce and deliver up any such vouchers or receipts, books, papers, writings, property, or things, as aforesaid, in accordance with the provisions of this Act, and that he still fails or refuses so to do, the Court may commit the offender to gaol, there to remain without bail until he has rendered such accounts, paid over such moneys, and produced and delivered up all such vouchers, receipts, books, papers, writings, property and things, in respect of which the charge was made: Provided that a person shall not be imprisoned under this section for a period exceeding six months.

No proceeding under this section shall be construed to relieve or discharge any surety of the offender from any liability whatever.

Mode of defraying expenses of urban authority.

207.—All expenses incurred or payable by an urban authority in the execution of this Act, and not otherwise provided for, shall be charged on and defrayed out of the district fund and general district rate leviable by them under this Act, subject to the following exceptions, namely:—

That if in any district the expenses incurred by an urban authority (being the council of a borough) in the execution of the Sanitary Acts were at the time of the passing of this Act payable out of the borough fund or borough rate, then the expenses incurred by that authority in the execution of this Act shall be charged on and defrayed out of the borough fund or borough rate ; and

That, if in any district the expenses incurred by an urban authority (being improvement commissioners) in the execution of the Sanitary Acts were, at the time of the passing of this Act, payable out of any rate in the nature of a general district rate leviable by them as such commissioners throughout the whole of their district, then the expenses incurred by that authority in the execution of this Act shall be charged on and defrayed out of such rate ; and for the purposes of this section the council of the borough of Folkestone shall be deemed to be improvement commissioners ; and

That where at the time of the passing of this Act the expenses incurred by an urban authority in the execution of certain purposes of the Sanitary Acts were payable out of the borough fund and borough rate, and the expenses incurred by such authority in the execution of the other purposes of the said Acts were payable out of a rate or rates leviable by that authority throughout the whole of their district for paving, sewerage, and other sanitary purposes, then the expenses incurred by that authority in the execution of the same or similar purposes respectively under this Act shall respectively be charged on and defrayed out of the borough fund and borough rate, and out of the rate or rates leviable as aforesaid.

Power in certain cases by provisional order to alter mode.

208.—Where at the time of the passing of this Act the expenses incurred by an urban authority for sanitary purposes are payable otherwise than in the manner provided by the Local Government Acts, the Local Government Board may, on the application of such authority, or of any ten persons rated to the relief of the poor within the district, declare by provisional order that the expenses of such authority incurred in the execution of this Act shall be defrayed out of a district fund and general district rate to be levied by them under this Act, subject to the provisions of this Act with respect to the mode of defraying in certain cases the expenses of the repair of highways.

District fund account.

209.—In the district of every urban authority whose expenses under this Act are directed to be defrayed out of the district fund and general district rate there shall be continued or established a fund called the

district fund : a separate account called "the District Fund Account" of all moneys carried under this Act to the account of that fund shall be kept by the treasurer of the urban authority ; and such moneys shall be applied by the urban authority in defraying such of the expenses chargeable thereon under this Act as they may think proper.

Making general district rate.

210.—For the purpose of defraying any expenses chargeable on the district fund which that fund is insufficient to meet, the urban authority shall from time to time, as occasion may require, make by writing under their common seal, and levy in addition to any other rate leviable by them under this Act, a rate or rates to be called "general district rates."

Any such rate may be made and levied either prospectively in order to raise money for the payment of future charges and expenses, or retrospectively in order to raise money for the payment of charges and expenses incurred at any time within six months before the making of the rate : in calculating the period of six months during which the rate may be made retrospectively, the time during which any appeal or other proceeding relating to such rate is pending shall be excluded.

Public notice of intention to make any such rate, and of the time when it is intended to make the same, and of the place where a statement of the proposed rate is deposited for inspection, shall be given by the urban authority in the week immediately before the day on which the rate is intended to be made, and at least seven days previously thereto ; but in case of proceedings to levy or recover any rate it shall not be necessary to prove that such notice was given.

BORROWING POWERS.

Power to borrow on credit of rates.

233.—Any local authority may, with the sanction of the Local Government Board, for the purpose of defraying any costs, charges, and expenses incurred or to be incurred by them in the execution of the Sanitary Acts or of this Act, or for the purpose of discharging any loans contracted under the Sanitary Acts or this Act, borrow or re-borrow, and take up at interest, any sums of money necessary for defraying any such costs, charges, and expenses, or for discharging any such loans as aforesaid.

An urban authority may borrow or re-borrow any such sums on the credit of any fund or all or any rates or rate out of which they are authorised to defray expenses incurred by them in the execution of this Act, and for the purpose of securing the repayment of any sums

so borrowed, with interest thereon, they may mortgage to the persons by or on behalf of whom such sums are advanced any such fund or rates or rate.

A rural authority may borrow or re-borrow any such sums, if applied or intended to be applied to general expenses of such authority, on the credit of the common fund out of which such expenses are payable, and if applied or intended to be applied to special expenses of such authority, on the credit of any rate or rates out of which such expenses are payable, and for the purpose of securing the repayment of any sums so borrowed, with interest thereon, they may mortgage to the persons by or on behalf of whom such sums are advanced any such fund, rate, or rates.

Regulations as to exercise of borrowing powers. .

234.—The exercise of the powers of borrowing conferred by this Act shall be subject to the following regulations ; (namely)

- (1) Money shall not be borrowed except for permanent works (including under this expression any works of which the cost ought in the opinion of the Local Government Board to be spread over a term of years) :
- (2) The sum borrowed shall not at any time exceed, with the balances of all the outstanding loans contracted by the local authority under the Sanitary Acts and this Act, in the whole, the assessable value for two years of the premises assessable within the district in respect of which such money may be borrowed.
- (3) Where the sum proposed to be borrowed with such balances (if any) would exceed the assessable value for one year of such premises, the Local Government Board shall not give their sanction to such loan until one of their inspectors has held a local inquiry and reported to the said Board :
- (4) The money may be borrowed for such time, not exceeding sixty years, as the local authority, with the sanction of the Local Government Board, determine in each case ; and, subject as aforesaid, the local authority shall either pay off the moneys so borrowed by equal annual instalments of principal, or of principal and interest, or they shall in every year set apart as a sinking fund, and accumulate in the way of compound interest by investing the same in the purchase of Exchequer Bills or other Government securities, such sum as will with accumulations in the way of compound interest be sufficient, after payment of all expenses, to pay off the moneys so borrowed within the period sanctioned :

- (5) A local authority may at any time apply the whole or any part of a sinking fund set apart under this Act in or towards the discharge of the moneys for the repayment of which the fund has been established: Provided that they pay into the fund in each year and accumulate until the whole of the moneys borrowed are discharged a sum equivalent to the interest which would have been produced by the sinking fund or the part of the sinking fund so applied:
- (6) Where money is borrowed for the purpose of discharging a previous loan, the time for repayment of the money so borrowed shall not extend beyond the unexpired portion of the period for which the original loan was sanctioned, unless with the sanction of the Local Government Board, and shall in no case be extended beyond the period of sixty years from the date of the original loan.

Where any urban authority borrow any money for the purpose of defraying private improvement expenses, or expenses in respect of which they have determined a part only of the district to be liable, it shall be the duty of such authority, as between the ratepayers of the district, to make good, so far as they can, the money so borrowed, as occasion requires, either out of private improvement rates, or out of a rate levied in such part of the district as aforesaid.

Power to borrow on credit of sewage and land plant.

235.—Where any local authority are possessed of any lands, works or other property for the purposes of disposal of sewage pursuant to this Act, they may borrow any moneys on the credit of such lands, works, or other property, and may mortgage such lands, works, or other property to any person advancing such moneys, in the same manner in all respects as if they were the absolute owner, both at law and in equity, of the lands, works, or other property so mortgaged. The moneys so borrowed shall be applied for purposes for which moneys may be borrowed under this Act, but it shall not be in any way incumbent on the mortgagees to see to the application of such moneys, nor shall they be responsible for any misapplication thereof.

The powers of borrowing conferred by this section shall, where the sums borrowed do not exceed three-fourths of the purchase-money of such lands (but not otherwise) be deemed to be distinct from, and in addition to, the general borrowing powers conferred on a local authority by this Act. Any local authority may pay out of any rates leviable by them for purposes of this Act the interest on any moneys borrowed by such authority in pursuance of this section.

Audit where urban authority are a town council.

246.—Where an urban authority are the council of a borough the accounts of the receipts and expenditure under this Act of such authority shall be audited and examined by the auditors of the borough, and shall be published in like manner, and at the same time, as the municipal accounts, and the auditors shall proceed in the audit after like notice and in like manner, shall have like powers and authorities, and perform like duties, as in the case of auditing the municipal accounts.

Each of such auditors shall in respect of each audit be paid such reasonable remuneration, not being less than two guineas for every day in which they are employed in such audit, as such authority from time to time appoint. Any order of such authority for the payment of any money may be moved by *certiorari*, and like proceedings may be had thereon as under section forty-four of the Act of the first year of Her Majesty, chapter seventy-eight, with respect to orders of the council of a borough for payments out of the borough fund.

Audit where urban authority are not a town council.

247.—Where an urban authority are not the council of a borough the following regulations with respect to audit shall be observed; (namely)

- (1) The accounts of the receipts and expenditure under this Act of such authority shall be audited and examined once in every year, as soon as can be after the twenty-fifth day of March, by the auditor of accounts relating to the relief of the poor for the union in which the district of such authority, or the greater part thereof, is situate, unless such auditor is a member of the authority whose accounts he is appointed to audit, in which case such accounts shall be audited by such auditor of any adjoining union as may from time to time be appointed by the Local Government Board:
- (2) There shall be paid to such auditor in respect of each audit under this Act, such reasonable remuneration, not being less than two guineas for every day in which he is employed in such audit, as such authority from time to time appoint, together with his expenses of travelling to and from the place of audit:
- (3) Before each audit such authority shall, after receiving from the auditor the requisite appointment, give at least fourteen days' notice of the time and place at which the same will be made, and of the deposit of accounts required by this section, by advertisement in some one or more of the local newspapers circulated in the district; and the production of the newspaper containing such notice shall be deemed to be sufficient proof of such notice on any proceeding whatsoever:

- (4) A copy of the accounts, duly made up and balanced, together with all rate books, account books, deeds, contracts, accounts, vouchers, and receipts mentioned or referred to in such accounts, shall be deposited in the office of such authority, and be open during office hours thereat, to the inspection of all persons interested for seven clear days before the audit, and all such persons shall be at liberty to take copies of, or extracts from, the same without fee or reward; and any officer of such authority duly appointed in that behalf neglecting to make up such accounts and books, or altering such accounts and books, or allowing them to be altered when so made up, or refusing to allow inspection thereof, shall be liable to a penalty not exceeding five pounds:
- (5) For the purpose of any audit under this Act, every auditor may, by summons in writing, require the production before him of all books, deeds, contracts, accounts, vouchers, receipts, and other documents and papers which he may deem necessary, and may require any person holding or accountable for any such books, deeds, contracts, accounts, vouchers, receipts, documents, or papers to appear before him at any such audit or any adjournment thereof, and to make and sign a declaration as to the correctness of the same; and if any such person neglects or refuses so to do, or to produce any such books, deeds, contracts, accounts, vouchers, receipts, documents, or papers, or to make or sign such declaration, he shall incur for every neglect or refusal a penalty not exceeding forty shillings; and if he falsely or corruptly makes or signs any such declaration, knowing the same to be untrue in any material particular, he shall be liable to the penalties inflicted on persons guilty of wilful and corrupt perjury:
- (6) Any ratepayer or owner of property in the district may be present at the audit, and may make any objection to such accounts before the auditor; and such ratepayers and owners shall have the same right of appeal against allowances by an auditor as they have by law against disallowances:
- (7) Any auditor acting in pursuance of this section shall disallow every item of account contrary to law, and surcharge the same on the person making or authorising the making of the illegal payment, and shall charge against any person accounting the amount of any deficiency or loss incurred by the negligence or misconduct of that person, or of any sum which ought to have been, but is not, brought into account by that person, and shall in every such case certify the amount due from such person, and

on application by any party aggrieved shall state in writing the reasons for his decision in respect of such disallowance or surcharge, and also of any allowance which he may have made :

- (8) Any person aggrieved by disallowance made may apply to the Court of Queen's Bench for a writ of *certiorari* to remove the disallowance into the said Court, in the same manner and subject to the same conditions as are provided in the case of disallowances by auditors under the laws for the time being in force with regard to the relief of the poor ; and the said Court shall have the same powers with respect to allowances, disallowances, and surcharges under this Act as it has with respect to disallowances or allowances by the said auditors ; or in lieu of such application any person so aggrieved may appeal to the Local Government Board, which Board shall have the same powers in the case of the appeal as it possesses in the case of appeals against allowances, disallowances and surcharges by the said poor law auditors :
- (9) Every sum certified to be due from any person by an auditor under this Act shall be paid by such person to the treasurer of such authority within fourteen days after the same has been so certified, unless there is an appeal against the decision ; and if such sum is not so paid, and there is no such appeal, the auditor shall recover the same from the person against whom the same has been certified to be due by the like process, and with the like powers, as in the case of sums certified on the audit of the poor rate accounts, and shall be paid by such authority all such costs and expenses, including a reasonable compensation for loss of time incurred by him in such proceedings, as are not recovered by him from such person :
- (10) Within fourteen days after the completion of the audit, the auditor shall report on the accounts audited and examined, and shall deliver such report to the clerk of such authority, who shall cause the same to be deposited in their office, and shall publish an abstract of such accounts in some one or more of the local newspapers circulated in the district.

Where the provisions as to audit of any local Act constituting a board of improvement commissioners are repugnant to, or inconsistent with, those of this Act, the audit of the accounts of such improvement commissioners shall be conducted in all respects in accordance with the provisions of this Act.

LOCAL BOARDS' ACCOUNTS ORDER 1880.

FORM (O).

.....LOCAL GOVERNMENT DISTRICT.

FINANCIAL STATEMENT.

The District Auditors Act 1879 (42 Vict. c. 6).

**STATEMENT of Receipts and Expenditure by the Local Board for the
above-named Local Government District for the year ended the 25th
day of March 188 .**

RECEIPTS OTHER THAN FROM LOANS.

	Amounts				Totals			
	£	s	d		£	s	d	
PUBLIC RATES.								
From General District Rate	
From Special District Rate (if any)	
From Highway Rate	
From Water Supply Rate	
From Gas Supply Rate	
From Market Tolls or other Dues and Duties (if any)	
From Precepts in respect of expenses of School Attendance Committee (if any)	
PRIVATE RATES.								
From Private Improvement Rates	
From Water Supply Rates or Rents	
OTHER RECEIPTS.								
From Parliamentary Grant {	Salary of Medical Officer of Health							
	Salary of Inspector of Nuisances							
District Fund Account (if any)	
From all other sources	
BURIAL BOARD RECEIPTS.								
Amount of the Receipts by the Local Board as a Burial Board, where acting in the latter capacity	
Gross Receipts	

FORM (O).—FINANCIAL STATEMENT—continued.
EXPENDITURE OTHER THAN FROM LOANS.

	Amounts			Totals		
	£	s	d	£	s	d
PUBLIC WORKS.						
Sewerage						
Water Supply						
Gas Supply						
Highways (less amount* borne by County Authority in respect of repairs of Main Roads, if any)						
Scavenging and Watering						
Parks or Public Pleasure Grounds						
Hospitals						
Other Public Works						
	£	s	d			
* Amount borne by County Authority						
PRIVATE IMPROVEMENT WORKS.						
Drainage and Water Supply						
Other Private Improvement Works						
Amount of Expenditure on Public Works and Private Improvement Works						
GENERAL EXPENDITURE.						
Election Expenses						
Legal Expenses						
Salaries (less amount† borne by Parliamentary Grant), viz.:	Clerk					
	Treasurer					
	Medical Officer of Health					
	Inspector of Nuisances					
	Surveyor					
Establishment Charges, other than Salaries						
Repayment of Loans, with Interest ‡						
Expenses of School Attendance Committee (if any)						
Other Payments (excluding contributions on Precepts of Joint Boards or Port Sanitary Authorities)†						
† Amount borne by Parliamentary Grant:	£ s d					
Medical Officer of Health						
Inspector of Nuisances						
‡ Amount paid on Precepts:	£ s d					
To Joint Boards						
To Port Sanitary Authorities						
BURIAL BOARD EXPENDITURE.						
Amount of Expenditure by the Local Board as a Burial Board, where acting in the latter capacity**						
Total Expenditure included in this Statement						

‡ The particulars required with respect to Loans are to be supplied in the Form (Q) annexed.

** The amount to be inserted here will be the total expenditure shown in the Form (P) annexed.

_____ Clerk [or _____] to the Local Board,
_____ day of _____ 188 .

I hereby certify that I have compared the entries in the above Statement with the Vouchers and other documents relating thereto, and that the regulations with respect to such Statement have been duly complied with.

I hereby further certify that I have ascertained by Audit the correctness of such Statement, and that the amount expended by the Local Board during the year ended the 25th day of March 188 , as included in such Statement and allowed by me at the Audit, is [here insert the amount in words at length].

As witness my hand this _____ day of _____ 188 .

Stamp

District Auditor.

FORM (Q).—LOAN ACCOUNT.

..... LOCAL GOVERNMENT DISTRICT.

STATEMENT with reference to Loans obtained by the Local Board for the above-named District
[otherwise than as a Burial Board].*

Year ended the Twenty-fifth day of March 188 .

Amount originally advanced	When advanced	Whether by Public Works Loan Commissioners, a Company,† or otherwise	For what object;	For what period	Rate of Interest	Mode of Repayment, whether by Annuity or otherwise	Amounts paid this year		Amount of Principal still owing	SINKING FUND			
							Principal	Interest		Amount annually set apart	Rate of Interest on which Fund is based	Total sum in Fund	Securities in which Fund is invested, and Rate of Interest payable on them
£							£	£	£	£		£	

* Where the Local Board do not act as a Burial Board, the second of these tabular statements [see next page] is to be omitted, as well as the words within brackets at the head of the first of the statements [above].

† If by a Company, insert the name.

‡ Where all or any portion of the Loan has been expended during the year, state the nature of the works and the amount expended in each case.

Nature of Works	Amount expended
	£

FORM (Q).—LOAN ACCOUNT—continued.

.....LOCAL GOVERNMENT DISTRICT.

* STATEMENT with reference to Loans obtained by the Local Board for the above-named District, acting as the Burial Board.

Year ended the Twenty-fifth day of March 188 .

Amount originally advanced	When advanced	Whether by Public Works Loan Commissioners, a Company,† or otherwise	For what object ;	For what period	Rate of Interest	Mode of Repayment, whether by Annuity or otherwise	Amounts paid this year		Amount of Principal still owing	SINKING FUND			
							Principal	Interest		Amount annually set apart	Rate of Interest on which Fund is based	Total Sum in Fund	Securities in which Fund is invested and Rate of Interest payable on them
£							£	£	£	£		£	

* Where the Local Board do not act as a Burial Board, the second of the above tabular statements is to be omitted, as well as the words within brackets at the head of the first of those statements.

† If by a Company, insert the name.

‡ Where all or any portion of the Loan has been expended during the year, state the nature of the works and the amount expended in each case.

Nature of Works	Amount expended
	£

_____ Clerk to the Local Board,
_____ day of _____ 188 .

Examined by me in connection with the Financial Statement for the year ended the 25th day of March 188 , and found correct.

_____ District Auditor.

_____ day of _____ 188 .

NOTE.—It is only required that money be entered in the Form above to the nearest £; whenever the fractional parts, in abstracting from the Books, amount in their total to 10s. or more than 10s. they are to be taken as equal to £1; if less than 10s. they are to be rejected. Thus, £175 10s. should be entered as £176, but £175 9s. 11d. as £175 only.

THE MUNICIPAL CORPORATIONS ACT 1882.

*45 and 46 Vict. c. 50.**The treasurer.*

18.—(1) The council shall from time to time appoint a fit person, not a member of the council, to be the treasurer of the borough.

(2) The treasurer shall hold office during the pleasure of the council.

(3) A vacancy in the office shall be filled within twenty-one days after its occurrence.

(4) The offices of town clerk and treasurer shall not be held by the same person.

Other borough officers.

19.—The council shall from time to time appoint such other officers as have been usually appointed in the borough, or as the council think necessary, and may at any time discontinue the appointment of any officer appearing to them not necessary to be reappointed.

Security by, and remuneration of officers.

20.—The council shall require every officer appointed by them to give such security as they think proper for the due execution of his office, and shall allow him such remuneration as they think reasonable.

Accountability of officers.

21.—(1) Every officer appointed by the council shall at such times during the continuance of his office, or within three months after his ceasing to hold it, and in such manner as the council direct, deliver to the council, or as they direct, a true account in writing of all matters committed to his charge, and of his receipts and payments, with vouchers, and a list of persons from whom money is due for purposes of this Act in connection with his office, showing the amount due from each.

(2) Every such officer shall pay all money due from him to the treasurer, or as the council direct.

(3) If any such officer—

(a) Refuses or wilfully neglects to deliver any account or list which he ought to deliver, or any voucher relating thereto, or to make any payment which he ought to make; or

- (b) After three days' notice in writing, signed by the town clerk or by three members of the council, given or left at his usual or last known place of abode, refuses or wilfully neglects to deliver to the council, or as they direct, any book or document which he ought so to deliver, or to give satisfaction respecting it to the council, or as they direct ;

a court of summary jurisdiction having jurisdiction where the officer is or resides may, by summary order, require him to make such delivery or payment, or to give such satisfaction.

- (4) But nothing in this section shall affect any remedy by action against any such officer or his surety, except that the officer shall not be both sued by action and proceeded against summarily for the same cause.

ACCOUNTS AND AUDIT.

The borough auditors.

25.—(1) There shall be three borough auditors, two elected by the burgesses, called elective auditors, and one appointed by the mayor, called mayor's auditor.

- (2) An elective auditor must be qualified to be a councillor, but may not be a member of the council, or the town clerk, or the treasurer.

- (3) The mayor's auditor must be a member of the council.

- (4) The term of office of each auditor shall be one year.

- (5) The appointment of the mayor's auditor shall be made on the ordinary day of election of the elective auditors.

- (6) On a casual vacancy in his office an appointment to fill it shall be made within ten days after the occurrence of the vacancy.

Audit and publication of treasurer's accounts.

27.—(1) The treasurer shall within one month from the date to which he is required to make up his accounts in each half-year, submit them, with the necessary vouchers and papers, to the borough auditors, and they shall audit them.

- (2) After the audit of the accounts for the second half of each financial year the treasurer shall print a full abstract of his accounts for that year.

Returns to Local Government Board.

28.—(1) The town clerk shall make a return to the Local Government Board of the receipts and expenditure of the municipal corporation for each financial year.

(2) The return shall be made for the financial year ending on the twenty-fifth of March, or on such other day as the Local Government Board, on the application of the council, from time to time prescribe.

(3) The return shall be in such form and contain such particulars as the Local Government Board from time to time direct.

(4) The return shall be sent to the Local Government Board within one month after the completion of the audit for the second half of each financial year.

(5) If the town clerk fails to make any return required under this section he shall for each offence be liable to a fine not exceeding twenty pounds, to be recovered by action on behalf of the Crown in the High Court.

(6) The Local Government Board shall in each year prepare an abstract of the returns made in pursuance of this section, under general heads, and it shall be laid before both Houses of Parliament.

CORPORATE LAND.

Power to purchase land for town hall, &c.

105.—A municipal corporation may contract for the purchase of and hold any land not exceeding in the whole five acres, either in or out of the borough, and thereon, or on any land belonging to or held in trust for the corporation, may build a town hall, council house, justices' room, with or without a police station and cells, or lock-ups, or a quarter and petty sessions house, or an assize court-house, with or without judges' lodgings, or a polling station, or any other building necessary or proper for any purpose of the borough.

Power to borrow with approval of Treasury.

106.—The council may, with the approval of the Treasury, borrow at interest on the security of any corporate land, or of any land proposed to be purchased by the council under this Act, or of the borough fund or borough rate, or of all or any of those securities, such sums as the council from time to time think requisite for the purchase of land, or for the building of any building which the council are by this Act authorised to build.

Restrictions on alienation of corporate land without approval of Treasury.

108.—(1) The council shall not, unless authorised by Act of Parliament, sell, mortgage, or alienate any corporate land without the approval of the Treasury.

(2) The council shall not, unless authorised by Act of Parliament, lease or agree to lease any corporate land without the approval of the Treasury, except as follows:—

- (a) They may make a lease or agreement for a lease for a term not exceeding thirty-one years from the date of the lease or agreement, so that there be reserved and made payable during the whole of the term such clear yearly rent as to the council appears reasonable, without any fine.
- (b) They may make a lease or agreement for a lease for a term not exceeding seventy-five years from the date of the lease or agreement, and either at a reserved rent or on a fine, or both, as the council think fit,—
 - (i.) Of tenements or hereditaments, the greater part of the yearly value of which, at the date of the lease or agreement, consists of any building or buildings; or
 - (ii.) Of land proper for the erection of any houses or other buildings thereon, with or without gardens, yards, curtilages, or other appurtenances to be used therewith; or
 - (iii.) Where the lessee or intended lessee agrees to erect a building or buildings thereon of greater yearly value than the land,—of land proper for gardens, yards, curtilages or other appurtenances to be used with any other house or other building erected or to be erected on any such land, belonging either to the corporation or to any other proprietor, or proper for any other purpose calculated to afford convenience or accommodation to the occupiers of any such house or building.

WORKING MEN'S DWELLINGS.

Sites for Working Men's Dwellings.

III.—(1) If a municipal corporation determines to convert any corporate land into sites for working men's dwellings, and obtains the approval of the Treasury for so doing, the corporation may, for that purpose, make grants or leases for terms of nine hundred and ninety-nine years, or any shorter term, of any parts of the corporate land.

(2) The corporation may make on the land any roads, drains, walls, fences, or other works requisite for converting the same into building land, at an expense not exceeding such sum as the Treasury approve.

(3) The corporation may insert in any grant or lease of any part of the land (in this section referred to as the site) provisions binding the grantee or lessee to build thereon as in the grant or lease prescribed, and to maintain and repair the building, and prohibiting the division

of the site or building, and any addition to or alteration of the character of the building, without the consent of the corporation, and for the re-vesting of the site in the corporation, or its entry thereon, on breach of any provision in the grant or lease.

(4) Every such provision shall be valid in law to all intents, and binding on the parties.

(5) All costs and expenses incurred or authorised by a corporation in carrying into execution or otherwise in pursuance of this section, shall be paid out of the borough fund and borough rate, or by money borrowed by the corporation under this Part.

(6) In this section the term "working men's dwellings" means buildings suitable for the habitation of persons employed in manual labour and their families; but the use of part of a building for purposes of retail trade or other purposes approved by the council shall not prevent the building from being deemed a dwelling.

REPAYMENT OF LOANS.

Power for Treasury to impose conditions as to repayment of money borrowed.

112.—(1) Where the Treasury approve a mortgage or charge under this Part they may, as a condition of their approval, require that the money borrowed on the security of the mortgage or charge be repaid, with all interest thereon, in thirty years, or any less period, and either by instalments or by means of a sinking fund, or both.

(2) In that case the sums required for providing for the repayment of the principal and interest of the money borrowed shall be by virtue of this Act a charge on all or any of the following securities, namely, the land comprised in the mortgage (without prejudice to the security thereby created), or any other corporate land, or the borough fund, or the borough or other rates legally applicable to payment of the money borrowed or of the expenses which the money is borrowed to defray, as the Treasury direct.

LOANS FOR MUNICIPAL BUILDINGS.

Power to borrow for buildings.

120.—The council of a borough may borrow money from the Public Works Loan Commissioners for the purpose of building, enlarging, repairing, improving, and fitting up any building which they are by this Act authorised to build, and may levy a rate or an increase of the borough rate for the purpose of paying the principal and interest of

the loan, and may mortgage the rate or borough rate to the Commissioners in accordance with the Public Works Loans Act 1875, or any amendment thereof, in such manner and form as the Commissioners direct.

BOROUGH FUND.

Payments to borough fund.

139.—The rents and profits of all corporate land, and the interest, dividends, and annual proceeds of all money, dues, chattels, and valuable securities belonging or payable to a municipal corporation, or to any member or officer thereof in his corporate capacity, and every fine or penalty for any offence against this Act (except where and as far as the application thereof is otherwise provided for) shall go to the borough fund.

Application of borough fund.

140.—(1) The borough fund shall be applicable to and charged with the several payments specified in the Fifth Schedule.

(2) The payments specified in Part I. of that schedule may be made without order of the council; those specified in Part II. may not be made without such order.

(3) No other payment shall be made out of the borough fund, except—

- (a) Under the authority of an Act of Parliament; or
- (b) By order of the council; or
- (c) By order of the Court of Quarter Sessions for the borough; or
- (d) By order of a justice in pursuance of this Act; or
- (e) In cases in which the Court of Quarter Sessions for a county, or a justice acting in and for a county in the discharge of his judicial duty, might make an order for the payment of money on the treasurer of the county.

(4) Saving, nevertheless, in relation to the application of the borough fund as authorised by this section, or otherwise by this Act, all rights, interests, and demands of all persons in or on the real or personal estate of the municipal corporation, by virtue of any legal proceeding, or of any mortgage, or otherwise.

Payments to and by treasurer.

142.—(1) All payments to and out of the borough fund shall be made to and by the treasurer.

(2) All payments to the treasurer shall go to the borough fund.

Application of surplus of borough fund.

143.—(1) If the borough fund is more than sufficient for the purposes to which it is applicable under this Act, or otherwise by law, the surplus thereof shall be applied under the direction of the council for the public benefit of the inhabitants and improvement of the borough.

(2) If the surplus arises from the rents and profits of the property of the municipal corporation, and not from a borough rate, and the borough is a sanitary district under the Public Health Act 1875, then the municipal corporation, as the sanitary authority for the borough, may apply the surplus in payment of any expenses incurred by them as such sanitary authority before or after the commencement of this Act, in improving the borough, or any part thereof, by drainage, enlargement of streets, or otherwise, under the Public Health Act 1875, or any Act thereby repealed.

BOROUGH RATE.

Power for council to make borough rate, and assess contribution thereto.

144.—(1) If the borough fund is insufficient for the purposes to which it is applicable under this Act or otherwise by law, the council shall from time to time estimate, as correctly as may be, what amount, in addition to the borough fund, will be sufficient for those purposes.

(2) In order to raise that amount, the council shall, subject to the provisions of this Act, from time to time order a rate, called a borough rate, to be made in the borough.

(3) A borough rate may be made retrospectively, in order to raise money for the payment of charges and expenses incurred, or which have come in course of payment, at any time within six months before the making of the rate.

(4) The council shall assess the contributions to the borough rate on the several parishes and parts of parishes in the borough in proportion to the total annual value of the hereditaments in each parish or part which are rateable to the poor, or in respect of which a contribution is made to the poor rate.

(5) That value shall be estimated according to the valuation list (if any) in force for the time being, and if there is none, according to the last poor rate.

(6) But if for any reason the council think that the valuation list or poor rate is not a fair criterion of value they may cause an independent valuation to be made.

(7) For the purpose of assessing a borough rate, or for the purpose of an independent valuation, the council from time to time may cause any of the books of assessment of any rates or taxes, Parliamentary or parochial, on any property, and the valuation by which the assessment is made, in the hands of the overseers, to be brought before them, and may take copies thereof or extracts therefrom, or may direct any person to take copies of or extracts from such books being in his hands, without having the same brought before the council, or may call before them any overseer to give evidence respecting the same; and may cause copies of the total amount assessed in each parish in respect of any tax payable to the Crown, and the total amount of the valuation of the property on which that assessment was made in any past year, to be made out by the clerk to the commissioners of each district.

(8) The overseers and such persons as they select, by warrant of the council, signed by the mayor and sealed with the corporate seal, may enter on, view, and examine any land chargeable to the borough rate, in order to ascertain the annual value at which it ought to be charged; but no such entry shall in any case be made unless fourteen days' previous notice in writing, signed by the mayor and sealed with the corporate seal, of the intention to make the entry, has been given to the overseers and to the persons on whose land the entry is to be made.

(9) If on any occasion the overseers of a parish think that their parish is aggrieved by a borough rate, on account of the proportions assessed as the contributions of the respective parishes being unequal, or on account of some parish being without sufficient cause omitted, or on account of any other just cause of complaint, they may appeal to the recorder at the next quarter sessions for the borough, or if there is none, to the next quarter sessions for the county wherein the borough is situate, or whereto it is adjacent, against such part of the rate only as affects their parish.

(10) The recorder or quarter sessions shall hear and finally determine the appeal, and either confirm such parts of the rate as are appealed against, or correct any inequalities, disproportions, or omissions proved to exist therein, as to him or them appears just.

(11) The expenses of the appeal shall be paid by such parishes or persons and in such proportions as the recorder or court having cognisance of the appeal directs.

(12) If any person having custody of any book for which the council call under this section fails to produce it to the council, or to permit any copy thereof or extract therefrom to be made or taken, or to give such evidence as the council require, he shall, on summary conviction, be liable to a fine not exceeding ten pounds.

(13) If any clerk to the commissioners of a district fails to make any copy, which he is required to make under this section, within a reasonable time after his receipt of the order to make it, he shall, on summary conviction, be liable to a fine not exceeding twenty pounds.

THE LOCAL GOVERNMENT ACT 1888.

51 and 52 Vict. c. 41.

68.—(1) All receipts of the County Council, whether for general or special county purposes, shall be carried to the county fund, and all payments for general or special county purposes shall be made in the first instance out of that fund.

(2) In this Act the expression “general county purposes” means all purposes declared by this or any other Act to be general county purposes, and all purposes for contributions to which the County Council are for the time being authorised by law to assess the whole area of their administrative county: and the expression “general county account” means the account of the county fund to which the contributions so raised are carried, and any costs incurred for a general county purpose shall be general expenses, and all costs incurred by the County Council in the execution of their duties which are not by law made special expenses shall be general expenses.

(3) In this Act the expression “special county purposes” means any purposes from contribution to which any portion of the county is for the time being exempt, and also includes any purposes where the expenditure involved is by law restricted to a hundred, division, or other limited part of the county, and the expression “special county account” means any account of the county fund to which contributions for special county purposes are carried, and any costs incurred for a special county purpose shall be special expenses.

(4) If the moneys standing to the general county account of the county fund are insufficient to meet the expenditure for general county purposes, county contributions may be levied to meet the deficiency on the whole administrative county, and shall be assessed on all the parishes in the county.

(5) If the moneys standing to any special county account of the county fund are insufficient to meet the expenditure for the special county purposes chargeable to that account, county contributions may be levied to meet the deficiency on any parishes in the county liable to be assessed to county contributions for those purposes.

(7) The County Council shall keep such accounts as will prevent the whole administrative county from being charged with expenditure properly payable by a portion only of the county, and will prevent any sums raised in a portion only of the county being applied in reduction of expenditure properly payable by the whole or a larger part of the county and will prevent any sums by law specifically applicable to any particular purpose from being applied to any other purpose.

(9) County contributions may be made retrospective in order to raise money for the payment of costs incurred or having become payable at any time within six months before the demand of the contributions.

71.—(1) The accounts of the receipts and expenditure of County Councils shall be made up to the end of each local financial year as defined by this Act, and be in the form for the time being prescribed by the Local Government Board.

(3) The accounts of a County Council and of the county treasurer and officers of such council shall be audited by the district auditors appointed by the Local Government Board in like manner as accounts of an urban authority and their officers under sections two hundred and forty-seven and two hundred and fifty of the Public Health Act 1875.

74.—(1) At the beginning of every local financial year, every County Council shall cause to be submitted to them an estimate of the receipts and expenses of such council during that financial year, whether on account of property, contributions, rates, loans, or otherwise.

(2) The council shall estimate the amount which will require to be raised in the first six months and in the second six months of the said financial year by means of contributions.

(3) If at the expiration of the first six months of such financial year it appears to the council that the amount of contribution, or rate estimated at the commencement of the year, will be larger than is necessary, or will be insufficient, the council may revise the estimate and alter accordingly the amount of the contribution or rate.

80.—(1) All payments to and out of the county fund shall be made to and by the county treasurer, and all payments out of the fund shall, unless made in pursuance of the specific requirement of an Act of Parliament, or of an order of a competent Court, be made in pursuance of an order of the council, signed by three members of the finance committee, present at the meeting of the council, and countersigned by the clerk of the council, and the same order may include several payments

(3) Every County Council shall from time to time appoint a finance committee for regulating and controlling the finance of their county; and the order for the payment of a sum out of the county fund, whether on account of capital or income, shall not be made by a County Council, except in pursuance of a resolution of the council passed on the recommendation of the finance committee, and (subject to the provisions of this Act respecting the standing joint committee) any costs, debt, or liability exceeding fifty pounds shall not be incurred except upon a resolution of the council, passed on an estimate submitted by the finance committee.

THE LOCAL GOVERNMENT ACT 1894.

56 and 57 Vict. c. 73.

58.—(1) The accounts of the receipts and payments of parish and district councils, and of parish meetings for parishes not having parish councils, and their committees and officers, shall be made up yearly to the thirty-first day of March, or in the case of accounts which are required to be audited half-yearly, then half-yearly to the thirtieth day of September and the thirty-first day of March in each year, and in such form as the Local Government Board prescribe.

(2) The said accounts shall, except in the case of accounts audited by the auditors of a borough (but inclusive of the accounts of a joint committee appointed by a borough council with another council not being a borough council), be audited by a district auditor, and the enactments relating to audit by district auditors of accounts of urban sanitary authorities and their officers, and to all matters incidental thereto and consequential thereon, shall apply accordingly, except that in the case of the accounts of rural district councils, their committees and officers, the audit shall be half-yearly instead of yearly.

(3) The Local Government Board may, with respect to any audit to which this section applies, make rules modifying the enactments as to publication of notice of the audit and of the abstract of accounts and the report of the auditor.

(4) Every parochial elector of a rural parish may, at all reasonable times, without payment, inspect and take copies of and extracts from all books, accounts, and documents belonging to or under the control of the parish council of the parish or parish meeting.

(5) Every parochial elector of a parish in a rural district may, at all reasonable times, without payment, inspect and take copies of and

extracts from all books, accounts, and documents belonging to or under the control of the district council of the district.

89.—The Acts specified in the second schedule to this Act are hereby repealed as from the appointed day to the extent in the third column of that schedule mentioned, and so much of any Act, whether public, general, or local and personal, as is inconsistent with this Act is also hereby repealed. . . .

FORM A.

[Form of Statement to be used when none of the Adoptive Acts are in force, and the Parish Council have no Financial transactions with regard to Charities.]

Parish Council for the Parish of

In the Rural District of

In the Administrative County of

FINANCIAL STATEMENT.

THE DISTRICT AUDITORS ACT 1879 (42 Vict. c. 6),

AND

THE LOCAL GOVERNMENT ACT 1894 (56 & 57 Vict. c. 73).

STATEMENT OF RECEIPTS AND PAYMENTS of the Parish Council for the above-named Parish for the period ended the 31st day of March 1895.

*Name of Clerk (or other person }
keeping the Accounts) _____*

Office Address _____

Post Town _____

RECEIPTS AND PAYMENTS by the

RECEIPTS.

PART

RECEIPTS OTHER THAN FROM LOANS.

	£ s d	£ s d
From Overseers on Precept, viz.:—		
From Poor Rates 		
[MEM.—The sums asked for in the Precepts issued during the period by the Parish Council were equal to pence in the £ on the rateable value of the parish, which was £ .]		
Sums received from other Local Authorities :—		
Name of Authority	On what Account	£ s d
<p>(The sums entered against the following headings are not to include receipts from other Local Authorities. See heading above.)</p> <div style="margin-top: 10px;"> Rents of Allotments Other Rents Dividends and Interest.. .. . Sales of Buildings and Lands Sales of Securities Fees, Fines, and Penalties Other Receipts (<i>specifying them</i>):— </div> <div style="float: right; margin-right: 50px;"> <div style="border-left: 1px solid black; padding-left: 10px; height: 80px;">£ s d</div> </div>		
TOTAL RECEIPTS		£

A—continued.

Parish Council for the Parish of.....

Council administering none of the Adoptive Acts (see sec. 7 of the
no accounts in regard to Charities.

I. PAYMENTS.

PAYMENTS OTHER THAN OUT OF LOANS.			£ s d	£ s d
Payments to Joint Committees or other Local Authorities (naming them) :—				
Name of Authority	On what Account	£ s d		
<div>(The sums entered against the following headings are not to include payments to other Local Authorities. See headings above.)</div> <div>Salaries of Officers</div> <div>* Establishment Charges</div> <div>Cost of Meetings, Polls, and Elections</div> <div>† Allotments</div> <div>† Footpaths and Rights of Way</div> <div>† Commons, Open Spaces, Public Walks and Recreation Grounds, and Works connected therewith</div> <div>† Fire Engine and Fire Escape</div> <div>† Maintenance and Repair of Parish Property not specified under other headings</div> <div>Other Payments (specifying them) :—</div>			£ s d	
Total Payments			£	
Balance in hand at the end of the year..			£	
TOTAL PAYMENTS AND BALANCE			£	

* The cost of Stationery, Printing, Books, Postage, and Office Rent, Rates, and Taxes should be entered against this heading.
† Where Salaries are paid exclusively to Officials employed on these or any other of the works and purposes enumerated on this page, the amounts of such salaries should be included in the items entered under the heading relating to the work or purpose, and not under the heading "Salaries of Officers."

FORM A—continued.

PART II.

SUMMARY of the Receipts and Payments shown in the foregoing Statement.

Receipts:—	£ s d
Payments:—	
Deduct:— Payments under Precept to other Local Authorities, if any, viz.:—	£ s d
Net Expenditure on which Stamp Duty is payable	£

{ Clerk to Parish Council, or
Chairman of Parish Council.

This _____ day of _____ 1895.

TOTAL PAYMENTS as shown above.. .. .	£ s d
Less amount disallowed at Audit	
AMOUNT ALLOWED AT AUDIT	

I HEREBY CERTIFY that I have compared the entries in this Financial Statement with the Vouchers and other Documents relating thereto, and that the regulations with respect to such Statement have been duly complied with.

I HEREBY FURTHER CERTIFY that I have ascertained by Audit the correctness of such Statement, and that the amount expended by the Parish Council during the period ended the 31st day of March 1895, as included in such Statement, and allowed by me at the Audit, is * _____

STAMP _____ District Auditor.

* The amount to be inserted in words at length.

BUILDING SOCIETY ACCOUNTS.**THE BUILDING SOCIETIES ACT 1874.**

37 and 38 Vict. c. 42.

13.—Any number of persons may establish a society under this Act, either terminating or permanent, for the purpose of raising by the subscriptions of the members a stock or fund for making advances to members out of the funds of the society, upon security of freehold, copyhold, or leasehold estate, by way of mortgage; and any society under this Act shall, so far as is necessary for the said purpose, have power to hold land with the right of foreclosure, and may from time to time raise funds by the issue of shares of one or more denominations, either paid up in full, or to be paid by periodical or other subscriptions, and with or without accumulating interest, and may repay such funds when no longer required for the purposes of the society; provided always, that any land to which any such society may become absolutely entitled by foreclosure, or by surrender, or other extinguishment of the right of redemption, shall as soon afterwards as may be conveniently practicable be sold or converted into money.

14.—The liability of any member of any society under this Act in respect of any share upon which no advance has been made shall be limited to the amount actually paid or in arrear on such share, and in respect of any share upon which an advance has been made shall be limited to the amount payable thereon under any mortgage or other security, or under the rules of the society.

15.—With respect to the borrowing of money by societies under this Act, the following provisions shall have effect:—

- (1) Any society under this Act may receive deposits or loans, at interest within the limits in this section provided, from the members or other persons, or from corporate bodies, joint stock companies or from any terminating building society to be applied to the purposes of the society:
- (2) In a permanent society the total amount so received on deposit or loan and not repaid by the society shall not at any time exceed two-thirds of the amount for the time being secured to the society by mortgages from its members:
- (3) In a terminating society the total amount so received and not repaid may either be a sum not exceeding such two-thirds as aforesaid, or a sum not exceeding twelve months' subscriptions on the shares for the time being in force:

(4) Any deposits with or loans to a society under this Act made before the commencement of this Act in accordance with its certified rules are hereby declared to be valid and binding on the society, but no further deposits or loans shall be received by such society, except within the limits provided by this section :

(5) Every deposit book or acknowledgment or security of any kind given for a deposit or loan by a society shall have printed or written therein or thereon the whole of the fourteenth and fifteenth sections of the present Act.

16.—The rules of every society hereafter established under this Act shall set forth :—

(6) The manner of appointing, remunerating, and removing the board of directors, or committee of management, auditors and other officers :

(8) Provision for an annual or more frequent audit of the accounts, and inspection by the auditors of the mortgages and other securities belonging to the society.

25.—Any society under this Act may from time to time, as the rules permit, invest any portion of the funds of the society not immediately required for its purposes, upon real or leasehold securities, or in the public funds, or in or upon any Parliamentary stock or securities, or in or upon any stock or securities, payment of the interest on which is guaranteed by authority of Parliament, or in the case of terminating societies, with other societies under this Act ; and for the purpose of investments in the public funds or upon security of copyhold or customary estate, the society, or the board of directors and committee of management thereof, may from time to time appoint and remove trustees.

29.—If any member of or depositor with a society under this Act, having in the funds thereof a sum of money not exceeding fifty pounds, shall die intestate, then the amount due may be paid to the person who shall appear to the directors or committee of management to the society to be entitled under the Statute of Distributions to receive the same, without taking out letters of administration, upon the society receiving satisfactory evidence of death and a statutory declaration that the member or depositor died intestate, and that the person so claiming is entitled as aforesaid : Provided that, whenever the society after the decease of any member or depositor has paid any such sum of money to the person who at the time appeared to be entitled to the effects of the deceased, under the belief that he had died intestate, the payment shall be valid and effectual with respect to any demand from any other person as next-of-kin or as the lawful representative

of such deceased member or depositor against the funds of the society, but, nevertheless, such next-of-kin or representative shall have his lawful remedy for the amount of such payment as aforesaid against the person who has received the same.

40.—The secretary or other officer of every society under this Act shall, once in every year at least, prepare an account of all the receipts and expenditure of the society since the preceding statement, and a general statement of its funds and effects, liabilities and assets, showing the amounts due to the holders of the various classes of shares respectively, to depositors and creditors for loans, and also the balance due or outstanding on their mortgage securities (not including prospective interest), and the amount invested in the funds or other securities; and every such account and statement shall be attested by the auditors, to whom the mortgage deeds and other securities belonging to the society shall be produced, and such account and statement shall be countersigned by the secretary or other officer; and every member, depositor, and creditor for loans shall be entitled to receive from the society a copy of such account and statement, and a copy thereof shall be sent to the registrar within fourteen days after the annual or other general meeting at which it is presented, and another copy thereof shall be suspended in a conspicuous place in every office of the society under this Act.

THE BUILDING SOCIETIES ACT 1894.

57 and 58 Vict. c. 47.

1.—The rules of every society under the Building Societies Acts established or substituting a new set of rules for its existing rules after the passing of this Act shall set forth—

- (a) The manner in which the stock or funds of the society is or are to be raised;
- (b) The terms upon which unadvanced subscription shares are to be issued; the manner in which the contributions are to be paid to the society, and withdrawn by the members, with tables, where applicable in the opinion of the registrar, showing the amount due by the society for principal and interest separately;
- (c) The terms upon which paid-up shares, if any, are to be issued and withdrawn, with tables, where applicable in the opinion of the registrar, showing the amount due by the society for principal and interest separately;

- (d) Whether preferential shares are to be issued, and, if so, within what limits ;
- (e) The manner in which advances are to be made and repaid ; the deductions, if any, for premiums, and the conditions upon which a borrower can redeem the amount due from him before the expiration of the period for which the advance was made, with tables, where applicable in the opinion of the registrar, showing the amount due from the borrower after each stipulated payment ;
- (f) The manner in which losses are to be ascertained and provided for ;
- (g) The manner in which membership is to cease ; and
- (h) Whether the society intends to borrow money, and, if so, within what limits not exceeding those prescribed by the Building Societies Acts.

2.—(1) Every annual account and statement under section 40 of the Building Societies Act 1874 shall be made up to the end of the official year of the society to which it relates, and shall be in such form and shall contain such particulars as the Chief Registrar of Friendly Societies may from time to time, with the approval of a Secretary of State, direct, either generally or with respect to any society or class of societies. The form of annual account and statement prescribed for general use by the Chief Registrar under this section, and every alteration of that form, shall as soon as practicable be laid before each House of Parliament, and shall not come into operation until the expiration of forty days from the date at which it is so laid. Provided that every such account and statement shall set forth—

- (a) With respect to mortgages to the society upon each of which the present debt does not exceed five thousand pounds (not being mortgages where the repayments are upwards of twelve months in arrear, or where the property has for upwards of twelve months been in possession of the society), the number of all such mortgages, and the aggregate amount owing thereon at the date of the account or statement, such information being given separately in respect of each of the four following classes :—
 - (i.) Where the debt does not exceed five hundred pounds :
 - (ii.) Where the debt exceeds five hundred pounds and does not exceed one thousand pounds :
 - (iii.) Where the debt exceeds one thousand pounds and does not exceed three thousand pounds :
 - (iv.) Where the debt exceeds three thousand pounds and does not exceed five thousand pounds ; and

(b) With respect to any other mortgage to the society, the particulars shown by the appropriate tabular form in the First Schedule to this Act.

(2) Every auditor, in attesting any such annual account or statement, shall either certify that it is correct, duly vouched, and in accordance with law, or specially report to the society in what respects he finds it incorrect, unvouched, or not in accordance with law, and shall also certify that he has at that audit actually inspected the mortgage deeds and other securities belonging to the society, and shall state the number of properties with respect to which deeds have been produced to and actually inspected by him.

(3) A copy of every such annual account and statement shall be sent to the registrar within fourteen days after the annual or other general meeting at which it is presented, or within three months after the expiration of the official year of the society, whichever period expires first.

(4) For the purposes of this section the expression "official year" shall mean, in the case of any society established after the passing of this Act, the year ending with the thirty-first day of December; and, in the case of any society established before the passing of this Act, the year ending with the time up to which its annual account and statement is made at the passing of this Act.

(5) This section shall not come into operation until the expiration of twelve months after the passing of this Act.

3.—Notwithstanding anything in the rules of any society under the Building Societies Acts, one at least of the auditors of the society shall be a person who publicly carries on the business of an accountant.

11.—If a society under the Building Societies Acts is dissolved in manner prescribed by its rules or in pursuance of the consent of three-fourths of the members, the liquidators, trustees, or other persons having the conduct of the dissolution shall, within twenty-eight days from the termination of the dissolution, send to the registrar an account and Balance Sheet signed and certified by them as correct, and showing the assets and liabilities of the society at the commencement of the dissolution, and the mode in which those assets and liabilities have been applied and discharged; and in default of so doing shall each be liable to a fine not exceeding five pounds for every day during which the default continues.

13.—(1) A society under the Building Societies Acts shall not advance money on the security of any freehold, copyhold, or leasehold estate which is subject to a prior mortgage, unless the prior mortgage is in favour of the society making the advance.

(2) Provided that this section shall not apply to any society in Scotland or Ireland which is at the passing of this Act authorised by the rules to make advances upon second mortgage.

(3) If any advance is made in contravention of this section, the directors of the society who authorised the advance shall be jointly and severally liable for any loss on the advance occasioned to the society.

14.—In calculating the amount for the time being secured to a society under the Building Societies Acts by mortgages from its members for the purpose of ascertaining the limits of its power to receive deposits or loans at interest, the amount secured on properties the payments in respect of which were upwards of twelve months in arrear at the date of the society's last preceding annual account and statement, and the amount secured on properties of which the society had been twelve months in possession at the date of such account and statement, shall be disregarded.

Provided that this section shall not affect the validity of any deposit or loan which was within the limit provided by law at the time when it was received, and so far as regards any amount secured either on properties the payments in respect of which are upwards of twelve months in arrear at the passing of this Act, or on properties in the possession of the society at the passing of this Act, shall not come into operation until the expiration of three years from the passing of this Act.

15.—(1) A society under the Building Societies Acts shall not use any name or title other than its registered name, and shall not accept any deposit except on the terms that not less than one month's notice may be required by the managers of the society before repayment or withdrawal.

(2) If a society contravenes this section, the society, and also every director or member of the committee of management who is a party to the contravention, shall be liable on summary conviction to a fine not exceeding ten pounds, and in the case of a continuing offence to an additional fine not exceeding ten pounds for every week during which the offence continues.

16.—(1) A society under the Building Societies Acts may—

(a) deposit in a savings bank any money belonging to the society, provided that the whole amount, exclusive of Government stock, credited by the bank to the society does not exceed three hundred pounds at any one time; and

- (b) invest in Government stock through a savings bank any money of the society, provided that the whole amount of Government stock credited by the bank to the society does not exceed five hundred pounds stock at any one time.

(5) In this section the expressions "savings bank" and "Government stock" have respectively the same meaning as in the Savings Bank Act 1893.

17.—The powers of investment under section 25 of the Building Societies Act 1874 shall include power to invest in or upon any security in which trustees are for the time being authorised by law to invest.

21.—If any society under the Building Societies Acts neglects or refuses—

- (a) To give any notice, send any return or document, or do or allow to be done anything which the society is by those Acts required to give, send, do or allow to be done; or
- (b) To do any act or furnish any information required for the purposes of those Acts by the registrar or by an inspector; the society and also every officer thereof bound by the rules thereof to fulfil the duty whereof a breach has been so committed, and if there is no such officer, then every member of the committee of management or board of directors of the society, unless it appears that he was ignorant of or attempted to prevent the breach, shall for each offence be liable, on summary conviction, to a fine not exceeding twenty pounds, and in the case of a continuing offence, to an additional fine not exceeding five pounds for every week during which the offence continues.

23.—No director, secretary, surveyor, solicitor, or other officer of a society under the Building Societies Acts shall, in addition to the remuneration prescribed or authorised by the rules of the society, receive from any other person any gift, bonus, commission, or benefit, for or in connection with any loan made by the society, and any person paying or accepting any such gift, bonus, commission, or benefit, shall be liable, on summary conviction, to a fine not exceeding fifty pounds, and, in default of payment, to be imprisoned with or without hard labour for any time not exceeding six months, and the person accepting any such gift, bonus, commission, or benefit shall, as and when directed by the Court by whom he is convicted, pay over to the society the amount or value of such gift, bonus, commission, or benefit, and in default of such payment shall be liable to be imprisoned with or without hard labour for any time not exceeding six months.

25.—(1) Section 40 of the Building Societies Act 1874 shall apply to every society which has been certified under the Building Societies Act 1836 (that is to say, the Act of the session held in the sixth and seventh years of King William the Fourth, chapter 32, intituled “An Act for the Regulation of Benefit Building Societies”), and has not been incorporated under the Building Societies Act 1874, and exists at the passing of this Act, and if any such society fails to comply with the requirements of that section, the society and its members and officers shall be subject to the like penalties as if the society were a society under the Building Societies Acts.

(2) On the expiration of two years from the passing of this Act, the said Building Societies Act 1836 shall be repealed as to all societies certified thereunder after the year one thousand eight hundred and fifty-six.

26.—The forms in the Third Schedule to this Act shall, after the commencement of this Act, be used under the Building Societies Acts.

SCHEDULES.
FIRST SCHEDULE.

PART I.

PARTICULARS to be set forth in the case of a Mortgage where the repayments are not upwards of twelve months in arrear, and the Property has not been upwards of twelve months in possession of the Society, and where the present Debt exceeds £5,000.

1	2	3	4	5	6	7	8	9
Date of Advance	Whether subject to any prior Mortgage or Charge. If so, what amount.	Whether Freehold, Copyhold, or Leasehold	Original Valuation of Property	Amount of Advance	Present Debt	Amount of Payments in Advance	Amount of Payments in Arrear	Observations
			£	£	£	£	£	
		Total ..						

PART II.

PARTICULARS to be set forth in the case of Property of which the Society has been upwards of twelve months in Possession.

1	2	3	4	5	6	7	8	9	10	11	12
Roll Numbers	Date of Advance	Date when Possession was taken	Whether subject to any prior Mortgage or Charge. If so, what amount.	Whether Freehold, Copyhold, or Leasehold	Amount of Advance	Original Valuation of Property	Debt when Possession was taken	Present Amount included in Assets	Gross Income for the Year	Outgoings for the Year	Observations
					£	£	£	£	£	£	
				Total ..							

PART III.

PARTICULARS to be set forth in the case of a Mortgage where the Repayments are upwards of twelve months in arrear and the property has not been upwards of twelve months in Possession of the Society.

1	2	3	4	5	6	7	8	9
Date of Advance	Whether subject to any prior Mortgage or Charge. If so, what amount.	Whether Freehold, Copyhold, or Leasehold	Number of Months in arrear	Original Valuation of Property	Amount of Advance	Present Debt	Amount of Payments in Arrear	Observations
				£	£	£	£	
			Total ..					

SECOND SCHEDULE.

ENACTMENTS REPEALED.

Session and Chapter.	Short Title.	Extent of Appeal.
37 & 38 Vict. c. 42	The Building Societies Act 1874.	Paragraphs 2 and 4 of section sixteen. In sec. 43 the words "in forwarding to the registrar any returns or information by this Act required or"; the words "or makes a return wilfully false in any respect"; the words "or who shall have made such wilfully false return"; and the words "or false return."
40 & 41 Vict. c. 63	The Building Societies Act 1877.	Sec. 6, and the schedule.

THIRD SCHEDULE.

CERTIFICATE OF INCORPORATION.

No. .

The Registrar of Building Societies in England [Scotland or Ireland] hereby certifies that the Building Society, established at in the county of is incorporated under the Building Societies Act 1874, this day of , one thousand eight hundred and . The incorporation of a building society does not imply any approval by the Registrar of its rules or tables or any guarantee of its good management or financial stability.

[Seal of Central Office, or signature of Assistant Registrar of Friendly Societies.]

CERTIFICATE OF REGISTRATION OF ALTERATION OF RULES.

The Registrar of Building Societies in England [Scotland or Ireland] hereby certifies that the foregoing alteration of [or addition to] the rules of the Building Society, established at in the county of is registered under the Building Societies Act 1874, this day of one thousand eight hundred and . The registry of rules or alterations does not imply any approval of them by the Registrar, or any guarantee of the good management or financial stability of the Society.

[Seal of Central Office, or signature of Assistant Registrar of Friendly Societies.]

CERTIFICATE OF REGISTRATION OF CHANGE OF NAME.

The Registrar of Building Societies in England [Scotland or Ireland] hereby certifies that the registered name of the Building Society, established at in the county of , is changed from the date hereof to the name following :—

This day of 189 .

[Seal of Central Office, or signature of Assistant Registrar of Friendly Societies.]

CERTIFICATE OF ALTERATION OF CHIEF OFFICE.

The Registrar of Building Societies in England [Scotland or Ireland] hereby certifies that the registered Chief Office of the Building Society, established at in the county of , is changed from the date hereof to the office or place following :—

This day of 189 .

[Seal of Central Office, or signature of Assistant Registrar of Friendly Societies.]

CERTIFICATE OF REGISTRATION OF INSTRUMENT OF DISSOLUTION.

The Registrar of Building Societies in England [Scotland or Ireland] hereby certifies that the foregoing instrument of dissolution of the Building Society, established at in the county of , is registered under the Building Societies Act 1874.

This day of 189 .

[Seal of Central Office, or signature of Assistant Registrar of Friendly Societies.]

CERTIFICATE OF AUDITORS.

We, the undersigned, _____, being a person who publicly carries on the business of an Accountant at No. _____, Street, _____, and residing at _____, the duly appointed auditors of the above-mentioned Society, do hereby attest the foregoing accounts and statements, and certify that they are correct, duly vouched, and in accordance with law, and we certify that we have, and each of us has at this audit actually inspected the Mortgage Deeds and other securities belonging to the Society, in respect of each of the Properties in mortgage to the Society referred to in the foregoing accounts and statements.

Signed _____

Signed _____

_____ day of _____ 18 ____.

Presented to the Annual General Meeting of the Society on the _____ day of _____ and adopted.

Signed _____ *Chairman*

Countersigned,

Secretary.

FORM OF ANNUAL ACCOUNT AND STATEMENT to be made by a society under the Building Societies Acts prescribed for general use by the Chief Registrar of Friendly Societies, with the approval of the Secretary of State.

Statement of Accounts of the Building Society (incorporated 18 and having its registered chief office or place of meeting at in the County of) for its th year, ending the day of 18

The number of members of the Society is

I.—RECEIPTS AND PAYMENTS ACCOUNT.				Cr.			
Dr.				£ s d			
To Balance (if any) at Bankers and in hand at beginning of year	£	s	d	By Balance (if any) due to Bankers at beginning of year	£	s	d
To Cash received during year, viz.:—				By Cash paid during year, viz.:—			
[Here are to be stated separately the amounts under each head of receipt]				[Here are to be stated separately the amounts under each head of payment]			
To Balance (if any) due to Bankers at end of year				By Balance (if any) at Bankers and in hand at end of year			

The address to which Rules, Returns, and other documents should be sent is as follows :—

ENGLAND AND WALES: Registry of Friendly Societies, Central Offices, 28 Abingdon Street, Westminster, London, S.W

SCOTLAND: Registry of Friendly Societies, 43 New Registry House, Edinburgh.

IRELAND: Registry of Friendly Societies, 16 Dame Street, Dublin.

2.—REVENUE (INCLUDING ACCRETIONS TO CAPITAL) AND EXPENDITURE ACCOUNT.

Balances at beginning of Year, as shown by last Annual Statement	Additions during the Year (Stating under each head the total amounts added, and not the excess of additions over diminutions)		Diminutions during the Year (Stating under each head the excess of diminution over addition)		Balances at end of Year, as shown by Liabilities and Assets Account
	Particulars	Amt. £ s d	Particulars	Amt. £ s d	
Due to Shareholders ..	Subscriptions of Shareholders Interest added Other additions, viz. :—		Withdrawals of Shareholders Interest Paid Other diminutions, viz. :—		Due to Shareholders (f)
Due to Depositors and other Creditors ..	New Deposits Interest added Other additions, viz. :—		Deposits withdrawn Interest paid Other diminutions, viz. :—		Due to Depositors and other Creditors (g) ..
Undivided Profit, not including Prospective Interest ..	Fines and Fees Other sources of Profit, viz. :—		Management expenses, viz. :—		Undivided Profit, not including Prospective Interest (g) ..
(A)	(B)		(C)		(D)
Total .. £			Total .. £		

Due on Mortgage Securities, not in- cluding Prospective Interest	£ s d	Advanced on Mort- gage Interest due from Borrowers Other Additions, viz.:—	£ s d	Repayment of Ad- vances Interest received from Borrowers Income from Proper- ties in possession .. Amount written off for Losses Other diminutions, viz.:—	£ s d	Due on Mortgage Securities, not in- cluding Prospective Interest (h)
Other Assets		Investments made, viz.:—		Investments realised, viz.:—		Other Assets (i) ..
Balance deficient (if any)		Interest on Invest- ments Other additions, viz.:—		Interest received .. Other diminutions, viz.:—		Balance deficient (if any) (h)
(A)		(B)		(C)		(D)
Total .. £		Total .. £		Total .. £		

A. and B. added together must equal C. and D. added together.

All the "Totals" must agree.

3.—LIABILITIES AND ASSETS ACCOUNT.

Dr

Cr

To Liabilities to Holders of Shares, viz :—		£ s d	
[State the liabilities for each class of Shares separately.]		Prin- cipal	Interest
		£ s d	£ s d
Paid-up Shares ..	..	..	..
Preferential Shares ..	..	..	..
Total ..	..	..	..
(c)			
To Liabilities to Depositors and other Creditors, viz :—		£ s d	
For Deposits payable at a fixed period ending within the next 12 months ..			
For Deposits payable at a fixed period ending after the next 12 months ..			
For Deposits payable upon various times of notice, viz :—			
Due to Bankers for Loans ..			
To other Creditors for Loans..			
Other Liabilities, viz :—			
Total ..	..	..	..
(f)			
To Undivided Profit (including Reserve Funds, but not including Prospective Interest), viz :—		£ s d	
By Balance due or outstanding on Mortgage Securities, not including Prospective Interest, viz :—		Prin- cipal	Interest accrued (not prospective)
		£ s d	£ s d
Mortgages from Members where the re- payments are not upwards of 12 months in arrear, and the property has not been upwards of 12 months in possession of			
On — where the debt does	..	..	..
On — Mortgages where the debt exceeds £500 and does not exceed £1,000 ..	..	..	..
On — Mortgages where the debt exceeds £1,000 and does not exceed £3,000 ..	..	..	..
On — Mortgages where the debt exceeds £3,000 and does not exceed £5,000 ..	..	..	..
On — Mortgages where the debt exceeds £5,000, as shown by Part I. of the Schedule ..	..	..	..
Total of Mortgages available under s. 14 of the Act of 1894 ..	..	..	..
[If the Society has any Mortgages from non- members, the like particulars as above are to be given in full for all such Mortgages.]			

	On — Mortgages on Property of which the Society has been upwards of 12 months in possession, as shown by Part II. of the Schedule		
(k)	On — Mortgages where the repayments are upwards of 12 months in arrear, and the property has not been upwards of 12 months in possession of the Society, as shown by Part III. of the Schedule..		
	Total number of prop- erties mortgaged } (l) to the Society ..	Total	(h)
	By other Assets:—		
	Amount invested in the Funds (bearing interest at — per cent.)		
	Amount invested in other securities, viz.:—		
		Nature of Security	Rate of Interest
	Other Assets, viz.:—		
	Cash at Bankers .. ..	..	..
	Cash in hands of — .. ..	..	..
	By Balance deficient (if any)..	..	..
(D)		(D)	(i)
			(k)

(D), (e), (f), (g), (h), (i), (k). These figures must agree with those in the last column of the Revenue and Expenditure Account.

(l). This figure must agree with that in the Certificate of the Auditors.

FRIENDLY SOCIETY ACCOUNTS.

FRIENDLY SOCIETIES ACT 1875.

38 and 39 Vict. c. 60.

[The whole of this Act is repealed by the Act of 1896 "except in so far as it relates to societies to which section 30 applies, and to industrial assurance societies."]

14.—With respect to the duties and obligations of registered societies the following provisions shall have effect :

(1) Every registered society shall—

(f) Once at least in every five years next after the commencement of this Act, or the registry of the society, and so again within six months after the expiration of every five years succeeding the date of the first valuation under this Act, either cause its assets and liabilities to be valued by a valuer to be appointed by the society, and send to the registrar a report, signed by such valuer, and which shall also state his address and calling or profession, on the condition of the society, and abstract to be made by him of the results of his valuation, together with a return containing such information with respect to the benefits assured and contributions receivable by the society, and of its funds and effects, debts and credits, as the registrar may from time to time require, or send to the registrar a return of the benefits assured and contributions receivable from all the members of the society, and of all its funds and effects, debts and credits, accompanied by such evidence in support thereof as the Chief Registrar prescribes, in which case the registrar shall cause the assets and liabilities of the society to be valued and reported on by some actuary, and shall send to the society a copy of his report, and an abstract of the results of his valuation :

(g) Allow any member or person having an interest in the funds of the society to inspect the books at all reasonable hours at the registered office of the society, or at any place where the same are kept, except that no such member or person, unless he be an officer of the society, or be specially authorised by a resolution of the society to do so, shall have the right to inspect the loan account of any other member without the written consent of such member.

30.—(8) A copy of every Balance Sheet of a society shall, during the seven days next preceding the meeting at which the same is to be presented, be kept open by the society for inspection at every office at which the business of the society is carried on, and shall be delivered or sent prepaid to every member on demand.

(9) The annual returns shall be certified by some person not an officer of the society (otherwise than as auditor thereof), carrying on publicly the business of an accountant, and if not so certified shall be deemed not to have been made.

35.—The Treasury may from time to time appoint public auditors and valuers for the purposes of this Act, and may determine from time to time the rates of remuneration to be paid by societies for the services of such auditors and valuers; but the employment of such auditors and valuers is not compulsory on any society.

36.—The Treasury may determine a scale of fees to be paid for matters to be transacted or for the inspection of documents under this Act; but no fees shall be payable on the registry of any friendly, benevolent, or cattle insurance society, or working men's club, or of any amendment of the rules of the same.

All fees which may be received by any registrar under, or by virtue of, this Act shall be paid into the receipt of Her Majesty's Exchequer.

37.—The Treasury shall, out of money to be provided by Parliament, pay to the chief and assistant registrars such salaries or other remunerations respectively, and such sums of money for defraying the expenses of office rent, salaries of assistants, clerks, and servants, remuneration for actuaries, accountants, and inspectors, computation of tables, publication of documents, diffusion of information, expenses of prosecutions, travelling expenses and other allowances of the chief or any assistant registrar, and other expenses which may be incurred for carrying out the purposes of this Act, and may also pay to any public auditors or valuers to be appointed under this Act such remuneration (if any) as the Treasury shall from time to time allow.

Schedule 2 states that the rules of societies registered under this Act must contain clauses to the following effect:—

(1) The keeping separate accounts of all moneys received or paid on account of every particular fund or benefit assured for which a separate table of contributions payable shall have been adopted, and the keeping separate account of the expenses of management, and of all contributions on account thereof.

(5) The investment of the funds, the keeping of the accounts, and the audit of the same once a year at least.

(6) Annual returns to the registrar of the receipts, funds, effects, and expenditure and numbers of members of the society.

(7) The inspection of the books of the society by every person having an interest in the funds of the society.

FRIENDLY SOCIETIES ACT 1896.

59 and 60 Vict. c. 25.

Consequences of Registry.

24.—(1) Every registered society and branch shall have a registered office to which all communications and notices may be addressed, and shall send to the registrar notice of the situation of that office, and of every change therein.

(2) In the case of a branch the notice shall be sent to the registrar through an officer appointed in that behalf by the society of which the branch forms part.

25.—(1) Every registered society and branch shall have one or more trustees.

(2) The trustees shall be appointed at a meeting of the society or branch, and by a resolution of a majority of the members present and entitled to vote thereat.

(3) The society or branch shall send to the registrar a copy of every resolution appointing a trustee, signed by the trustee so appointed, and by the secretary of the society or branch.

(4) The same person shall not be secretary or treasurer of a registered society or branch and a trustee of that society or branch.

(5) In the case of a branch the copy of the resolution shall be sent to the registrar through an officer appointed in that behalf by the society of which the branch forms part.

26.—(1) Every registered society and branch shall once at least in every year submit its accounts for audit either to one of the public auditors appointed as in this Act mentioned, or to two or more persons appointed as the rules of the society or branch provide.

(2) The auditors shall have access to all the books and accounts of the society or branch, and shall examine the annual return mentioned in this Act, and verify the annual return with the accounts and vouchers relating thereto, and shall either sign the annual return as

found by them to be correct, duly vouched, and in accordance with law, or specially report to the society or branch in what respects they find it incorrect, unvouched, or not in accordance with law.

27.—(1) Every registered society and branch shall once in every year, not later than the 31st day of May, send to the registrar a return (in this Act called the annual return) of the receipts and expenditure, funds, and effects of the society or branch as audited.

(2) The annual return must—

(a) show separately the expenditure in respect of the several objects of the society or branch; and

(b) be made out to the 31st day of December then last inclusively; and

(c) state whether the audit has been conducted by a public auditor appointed as by this Act provided, and by whom, and, if by persons other than a public auditor, state the name, address, and calling or profession of every such person, and the manner in which, and the authority under which, he is appointed.

(3) The society or branch shall, together with the annual return, send a copy of any special report of the auditors.

(4) In the case of a branch the annual return shall be sent to the registrar through an officer appointed in that behalf by the society of which the branch forms part.

28.—(1) Every registered society and branch shall, except as in this section provided, once at least in every five years either—

(a) cause its assets and liabilities to be valued by a valuer to be appointed by the society or branch and send to the registrar a report on the condition of the society or branch; or

(b) send to the registrar a return of the benefits assured and contributions receivable from all the members of the society or branch, and of all its funds and effects, debts and credits, accompanied by such evidence in support thereof as the Chief Registrar prescribes.

(2) If the society or branch sends to the registrar such report as aforesaid, the report must—

(a) be signed by the valuer; and

(b) state the address and calling or profession of the valuer; and

(c) contain an abstract to be made by the valuer of the results of his valuation, together with a statement containing such information with respect to the benefits assured and the contributions receivable by the society or branch, and of its funds and effects, debts and credits, as the registrar may require.

(3) If the society or branch sends to the registrar such return as aforesaid he shall cause the assets and liabilities of the society or branch to be valued and reported on by some actuary, and shall send to the society or branch a copy of the report and an abstract of the results of the valuation.

(4) Provided that this section shall not apply to—

(a) a benevolent society, working-men's club, cattle insurance society or branch thereof; or

(b) a specially authorised society or branch unless it is so directed in the authority for registering that society or branch.

(5) Provided also that the Chief Registrar may, with the approval of the Treasury, dispense with the provisions of this section in respect of societies or branches to whose purposes or to the nature of whose operations he may deem those provisions inapplicable.

29.—Every registered society and branch shall keep a copy of the last annual Balance Sheet, and of the last quinquennial valuation, together with any special report of the auditors, always hung up in a conspicuous place at the registered office of the society or branch.

30.—(1) For the purpose of audits and valuations to be made under this Act the Treasury may appoint public auditors and valuers and may determine the rates of remuneration to be paid by societies and branches for the services of those auditors and valuers; but the employment of those auditors and valuers shall not be compulsory.

(2) The Treasury may, out of money to be provided by Parliament, pay to the public auditors and valuers such remuneration (if any) as the Treasury may allow.

31.—(1) The rules of a registered cattle insurance society or branch, and of such specially authorised societies or branches thereof as the Treasury may allow to take the benefit of this section, shall bind the society or branch and the members thereof, and all persons claiming through them respectively, to the same extent as if each member had subscribed his name and affixed his seal thereto, and there were in the rules contained a covenant on the part of himself, his heirs, executors, and administrators, to conform to the rules subject to the provisions of this Act.

(2) All sums of money payable by a member to such society or branch as aforesaid shall be deemed to be a debt due from the member to the society or branch, and shall be recoverable as such in the County Court of the district in which the member resides.

33.—Stamp duty shall not be chargeable upon any of the following documents :—

(a) Draft or order or receipt given by or to a registered society or branch in respect of money payable by virtue of its rules or of this Act.

(b) Letter or power of attorney granted by any person as trustee for the transfer of any money of a registered society or branch invested in his name in the public funds.

(c) Bond given to or on account of a registered society or branch or by the treasurer or other officer thereof.

(d) Policy of insurance or appointment or revocation of appointment of agent or other document required or authorised by this Act or by the rules of a registered society or branch.

36.—(1) The rules of a registered society or branch may provide for the admission of a person under twenty-one years of age but above one year of age as a member.

(2) Any such member may, if he is over sixteen years of age by himself, and if he is under that age by his parent or guardian, execute all instruments and give all acquittances necessary to be executed or given under the rules, but shall not be a member of the committee, or a trustee, manager, or treasurer of the society or branch.

37.—A registered society or branch may subscribe out of its funds to any hospital, infirmary, charitable or provident institution, any annual or other sum which may be necessary to secure to members of the society or branch and their families the benefits of the hospital, infirmary or other institution, according to its rules.

Rights of Members.

39.—Every registered society and branch shall supply gratuitously to every member or person interested in its funds, on his application, either

(a) a copy of the last annual return of the society or branch ; or

(b) a Balance Sheet or other document duly audited containing the same particulars as to the receipts and expenditure, funds and effects, of the society or branch as are contained in the annual return.

40.—A member or person having an interest in the funds of a registered society or branch may inspect the books at all reasonable hours at the registered office of the society or branch, or at any place where the books are kept, except that the member or person shall not, unless

he is an officer of the society or branch, or is specially authorised by a resolution of the society or branch to do so, have the right to inspect the loan account of any other member without the written consent of that member.

41.—(1) A member, or person claiming through a member, of a registered friendly society or branch, shall not be entitled to receive more than two hundred pounds by way of gross sum, together with any bonuses or additions declared upon assurances not exceeding that amount, or (except as provided by this Act) fifty pounds a year by way of annuity, from any one or more such societies or branches.

(2) Any such society or branch may require a member, or person claiming through a member, to make and sign a statutory declaration that the total amount to which that member or person is entitled from one or more such societies or branches does not exceed the sums aforesaid.

42.—The rules of a registered society or branch may provide for accumulating at interest, for the use of any member, any surplus of his contributions to the funds of the society or branch which may remain after providing for any assurance in respect of which they are paid and for the withdrawal of the accumulations.

Property, Funds, and Investments.

44.—(1) The trustees of a registered society or branch may, with the consent of the committee or of a majority of the members present and entitled to vote in general meeting, invest the funds of the society or branch, or any part thereof, to any amount in any of the following ways:—

(a) In the Post Office Savings Bank, or in any savings bank certified under the Trustee Savings Banks Act 1863; or

(b) in the public funds; or

(c) with the National Debt Commissioners as in this Act provided; or

(d) in the purchase of land, or in the erection or alteration of offices or other buildings thereon; or

(e) upon any other security expressly directed by the rules of the society or branch, not being personal security, except as in this Act authorised with respect to loans.

(2) The rules of a society with branches and of any branch thereof may provide for the investment of funds of the society or of that branch by the trustees of any branch, or by the trustees of the society,

and the consent required for any such investment shall be the consent of the committee, or of such majority as aforesaid of the society or branch by whom the funds are invested.

45.—(1) A registered society and, subject to the rules of the society, a registered branch may advance to a member of at least one full year's standing any sum not exceeding one-half of the amount of an assurance on his life, on the written security of himself, and two satisfactory sureties for repayment.

(2) The amount so advanced, with all interest thereon, may be deducted from the sum assured, without prejudice in the meantime to the operation of the security.

46.—A registered society may, out of any separate loan fund to be formed by contributions or deposits of its members, make loans to members on their personal security, with or without sureties, as may be provided by the rules, subject to the following restrictions:—

(a) a loan shall not at any time be made out of money contributed for the other purposes of the society:

(b) a member shall not be capable of holding any interest in the loan fund exceeding two hundred pounds:

(c) a society shall not make any loan to a member on personal security beyond the amount fixed by the rules, or make any loan which, together with any money owing by a member to the society, exceeds fifty pounds:

(d) a society shall not hold at any one time on deposit from its members any money beyond the amount fixed by the rules, and the amount so fixed shall not exceed two-thirds of the total sums owing to the society by the members who have borrowed from the loan fund.

47.—(1) A registered society or branch may (if the rules thereof so provide) hold, purchase, or take on lease in the names of the trustees of the society or branch any land, and may sell, exchange, mortgage, lease, or build upon that land (with power to alter and pull down buildings and again rebuild), and a purchaser, assignee, mortgagee, or tenant shall not be bound to inquire as to the authority for any sale, exchange, mortgage, or lease by the trustees, and the receipt of the trustees shall be a discharge for all sums of money arising from or in connection with the sale, exchange, mortgage, or lease.

(2) A branch of a registered society need not for the purposes of this section be separately registered.

(3) Nothing in this section shall authorise a benevolent society to hold land exceeding one acre in extent.

48.—Where a registered society or branch is entitled in equity to any hereditaments of copyhold or customary tenure, either absolutely or by way of mortgage or security, the lord of the manor of which the hereditaments are held shall, if the society or branch so requires, admit not more than three trustees of the society or branch as tenants in respect of such hereditaments, on payment of the usual fines, fees, and other dues payable on the admission of a single tenant.

49.—(1) All property belonging to a registered society, whether acquired before or after the society is registered, shall vest in the trustees for the time being of the society, for the use and benefit of the society, and the members thereof, and of all persons claiming through the members according to the rules of the society.

(2) The property of a registered branch of a society shall vest wholly or partly in the trustees for the time being of that branch or of any other branch of which that branch forms part (or, if the rules of the society so provide, in the trustees for the time being of the society), for the use and benefit either of the members of any such branch and persons claiming through those members, or of the members of the society generally, and persons claiming through them, according to the rules of the society.

(3) The trustees shall not be liable to make good any deficiency in the funds of the society or branch, but shall be liable only for sums of money actually received by them respectively on account of the society or branch.

50.—Upon the death, resignation, or removal of a trustee of a registered society or branch, the property vested in that trustee shall, without conveyance or assignment, and whether the property is real or personal, vest, as personal estate subject to the same trusts, in the succeeding trustees of that society or branch either solely or together with any surviving or continuing trustees, and, until the appointment of succeeding trustees, shall so vest in the surviving or continuing trustees only, or in the executors or administrators of the last surviving or continuing trustee, except that stocks and securities in the public funds of Great Britain and Ireland shall be transferred into the names of the succeeding trustees, either solely or jointly with any surviving or continuing trustees.

51.—In all legal proceedings whatsoever concerning any property vested in the trustees of a registered society or branch, the property may be stated to be the property of the trustees in their proper names as trustees for the society or branch without further description.

52.—(1) A registered society or branch may pay to the account of the National Debt Commissioners at the Bank of England or the Bank of Ireland, as the case may require, any sum of money not less than fifty pounds upon a declaration of the trustees of the society or branch, or any two of them, that the money belongs exclusively to the society or branch.

(2) The cashier of the bank shall receive all such sums of money and place them to the account of the Commissioners in the book of the bank named "The Fund for Friendly Societies."

(3) A sum of money paid in upon a false declaration shall be forfeited to the Commissioners, and applied by them in the manner directed by section twelve of the Savings Banks Act 1891.

(4) The provisions of section twenty-one, twenty-two, twenty-four, twenty-five, twenty-six, twenty-seven, and twenty-eight of the Trustee Savings Banks Act 1863, as to the regulation of receipts, certificates, and orders, shall apply to money paid under this section.

(5) A society or branch so investing money with the Commissioners shall be entitled to a receipt entitling to interest at the following rates:—

To a friendly society or branch legally established before the twenty-eighth of July one thousand eight hundred and twenty-eight, which had invested funds with the Commissioners before the twenty-third of July one thousand eight hundred and fifty-five, a rate of interest in respect of any assurance made before the fifteenth of August one thousand eight hundred and fifty of

Threepence per
centum per diem.

To a friendly society or branch legally established between the twenty-eighth of July one thousand eight hundred and twenty-eight and the fifteenth of August one thousand eight hundred and fifty, which had invested funds with the Commissioners before the twenty-third of July one thousand eight hundred and fifty-five, a rate of interest in respect of any assurance made before the fifteenth of August one thousand eight hundred and fifty of

Twopence half-
penny per centum
per diem.

To a friendly society or branch legally established before the twenty-eighth of June one thousand eight hundred and eighty-eight, which had invested funds with the Commissioners before the first day of January one thousand eight hundred and ninety-six, a rate of interest in respect of any assurance made on or before the said twenty-eighth day of June of	Twopence per centum per diem.
To a society or branch in respect of any investment with the Commissioners, other than as hereinbefore in this section mentioned, a rate of interest of	Two pounds fifteen shillings per centum per annum.

(6) A society or branch withdrawing money so invested with the Commissioners shall not be entitled to make any further deposit without their consent.

(7) A society or branch so investing money with the Commissioners shall furnish such returns as may be required by the Commissioners, in respect of the funds deposited with them, and the assurances to which those funds relate.

(8) A society or branch having funds invested with the Commissioners at a rate higher than two pounds fifteen shillings per centum per annum shall retain at that rate so much only of its funds as arises from assurances made before the date applicable to that rate, after deducting all benefit payments and management expenses incurred on account of those assurances; and whenever the society or branch fails to satisfy the Commissioners of its title to retain at that rate any part of its funds, the Commissioners shall require the withdrawal thereof, or the transfer thereof to the rate of twopence per centum per diem, or two pounds fifteen shillings per centum per annum, as the case may require, and in default of withdrawal within thirty days, shall transfer the same in their books accordingly, and shall notify the transfer to the society or branch.

(9) Whenever it appears to the Commissioners that all the members of a society or branch assured before the fifteenth day of August one thousand eight hundred and fifty have died or ceased to be members, the Commissioners shall forthwith transfer in their books to the rate of twopence per centum per diem, or two pounds fifteen shillings per centum per annum, as the case may require, all funds of the society or branch remaining invested at any higher rate, and shall notify the transfer to the society or branch.

53.—(1) A receipt under the hands of the trustees of a registered society or branch, countersigned by the secretary, for all sums of money secured to the society or branch by any mortgage or other assurance, being in the form prescribed by this Act, if endorsed upon or annexed to the mortgage or other assurance, shall vacate the mortgage or assurance and vest the property therein comprised in the person entitled to the equity of redemption of that property, without reconveyance or surrender,

(2) If the mortgage or other assurance has been registered under any Act for the registration or record of deeds or titles, or is of copyholds or of lands of customary tenure and entered on any court rolls, the registrar under any such Act, or recording officer, or steward of the manor, or keeper of the register, shall, on production of the receipt, verified by oath of any person, enter satisfaction of the mortgage or charge made by the assurance on the register or court rolls, and shall grant a certificate, either upon the mortgage or assurance, or separately to the like effect.

(3) The certificate shall be received in evidence in all Courts and proceedings without further proof.

(4) The person making the entry shall be entitled for making the said entry and granting the said certificate to a fee of two shillings and sixpence, which in Ireland shall be paid by stamps and applied in accordance with the Public Offices Fees Act 1879.

(5) This section shall not extend to Scotland or the Island of Jersey.

Officers in Receipt or Charge of Money.

54.—Every officer of a registered society or branch having receipt or charge of money shall, if the rules of the society or branch so require, before taking upon himself the execution of his office, become bound with one sufficient surety at the least in a bond or give the security of a guarantee society, in such sum as the society or branch directs, conditioned for his rendering a just and true account of all sums of money received and paid by him on account of the society or branch at such times as its rules appoint, or as the society or branch or the trustees or committee thereof require him to do, and for the payment by him of all sums due from him to the society or branch.

55.—(1) Every officer of a registered society or branch having receipt or charge of money shall, at such times as by the rules of the society or branch he should render account, or upon demand made, or notice in writing given or left at his last or usual place of residence, give in his account as may be required by the society or branch, or by the trustees or committee thereof, to be examined and allowed or dis-

allowed by them, and shall, on the like demand or notice, pay over all sums of money and deliver all property in his hands or custody to such person as the society or branch, or the committee or the trustees, appoint.

(2) In case of any neglect or refusal to deliver the account, or to pay over the sums of money or to deliver the property in manner aforesaid, the trustees or authorised officers of the society or branch may sue upon the bond or security before mentioned, or may apply to the County Court or to a Court of summary jurisdiction, and the order of either such Court shall be final and conclusive.

Inspection : Cancelling and Suspension of Registry : Dissolution.

76.—(1) Upon the application—

(a) of one-fifth of the whole number of members of a registered society ; or

(b) in the case of a registered society of one thousand members and not exceeding ten thousand, of one hundred members ; or

(c) in the case of a registered society of more than ten thousand members, of five hundred members,

the chief registrar, or in cases of societies registered and doing business exclusively in Scotland or in Ireland the assistant registrars for Scotland and Ireland respectively, but with the consent of the Treasury in every case, may—

(a) appoint an inspector or inspectors to examine into and report on the affairs of the society ; or

(b) call a special meeting of the society.

(2) The application under this section shall be supported by such evidence, for the purpose of showing that the applicants have good reason for requiring an inspection to be made or meeting to be called, and that they are not actuated by malicious motives in their application, and such notice thereof shall be given to the society, as the chief registrar directs.

(3) The chief or assistant registrar may, if he thinks fit, require the applicants to give security for the costs of the proposed inspection or meeting, before appointing any inspector or calling the meeting.

(4) All expenses of and incidental to any such inspection or meeting shall be defrayed by the members applying therefor or out of the funds of the society, or by the members or officers, or former members or officers, of the society in such proportions as the chief or assistant registrar directs.

(5) An inspector appointed under this section may require the production of all or any of the books and documents of the society, and may examine on oath its officers, members, agents, and servants in relation to its business, and may administer such oath accordingly.

(6) The chief or assistant registrar may direct at what time and place a special meeting under this section is to be held and what matters are to be discussed and determined at that meeting, and the meeting shall have all the powers of a meeting called according to the rules of the society, and shall in all cases have power to appoint its own chairman, any rule of the society to the contrary notwithstanding.

(7) This section shall not apply to a society with branches, except with the consent of the central body of that society.

77.—(1) The chief registrar, or, in the case of a society registered and doing business in Scotland or Ireland exclusively, the assistant registrar for Scotland or Ireland, may—

(a) if he thinks fit, at the request of a society, to be evidenced in such manner as he may direct; or

(b) with the approval of the Treasury, on proof to his satisfaction that an acknowledgment of registry has been obtained by fraud or mistake, or that a society exists for an illegal purpose, or has wilfully and after notice from a registrar whom it may concern violated any of the provisions of this Act, or has ceased to exist, by writing under his hand cancel the registry of a society.

(2) The chief or assistant registrar, in any case in which he might, with the approval of the Treasury, cancel the registry of a society may, by writing under his hand, suspend the registry for any term not exceeding three months, and may, with the approval of the Treasury, renew the suspension for the like period.

(3) Unless the chief or assistant registrar has given to a registered society not less than two months' previous notice in writing, specifying briefly the ground of any proposed cancelling or suspension, the registry of the society shall not be cancelled (except at its request) or suspended.

(4) Where the registry of a society has been cancelled or suspended, notice thereof shall forthwith be advertised.

(5) Where the registry of a society has been suspended or cancelled, the society shall from the time of the suspension or cancelling (but if suspended, only while the suspension lasts, and subject also to the right of appeal given by this section) absolutely cease to enjoy as such the privileges of a registered society, but without prejudice to any

liability actually incurred by the society, and any such liability may be enforced against the society as if the suspension or cancelling had not taken place.

(6) A society may appeal from the cancelling of its registry, or from any suspension thereof which is renewed after six months, as follows:—

(a) from the assistant registrar for Scotland or Ireland to the chief registrar, and from him to the Court of Session in Scotland or the High Court in Ireland respectively; and

(b) from the chief registrar, in cases not relating exclusively either to Scotland or to Ireland, to the High Court in England.

78.—(1) Subject to the provision of this Act as to the dissolution of societies with branches, a registered society or branch may terminate or be dissolved in any of the following ways:—

(a) upon the happening of any event declared by the rules to be the termination of the society or branch; or

(b) as respects societies or branches other than friendly societies or branches, by the consent of three-fourths of the members, testified by their signatures to the instrument of dissolution; or

(c) as respects friendly societies or branches, by the consent of five-sixths in value of the members (including honorary members, if any), testified by their signatures to the instrument of dissolution, and also by the written consent of every person receiving or entitled to receive any relief, annuity, or other benefit from the funds of the society or branch, unless the claim of that person is first duly satisfied, or adequate provision made for satisfying that claim, and, in the case of a branch, with the consent of the central body of the society, or in accordance with the general rules of the society; or

(d) by the award of the chief registrar or assistant registrars in the cases specified in this Act.

(2) The provisions of this Act as to the method of calculating the value of members, and the remedy of members and persons dissatisfied with the provisions made for satisfying their claims in the case of the amalgamation or transfer of engagements of a registered friendly society, shall apply to the dissolution of a registered friendly society or branch.

79.—When a registered society or branch is terminated by an instrument of dissolution:—

(1) The instrument shall set forth—

(a) the liabilities and assets of the society or branch in detail; and

(b) the number of members and the nature of their interests in the society or branch; and

(c) the claims of creditors, if any, and the provision to be made for their payment; and

(d) the intended appropriation or division of the funds and property of the society or branch, unless the appropriation or division is stated in the instrument of dissolution to be left to the award of the chief registrar.

(2) Alterations in the instrument of dissolution may be made with the like consents as are in this Act required for the dissolution of a society or branch, testified in the same manner.

(3) A statutory declaration shall be made by one of the trustees, or by three members and the secretary of the society or branch, that the provisions of this Act have been complied with, and shall be sent to the registrar with the instrument of dissolution.

(4) The instrument shall not in the case of a registered friendly society or branch direct or contain any provision for a division or appropriation of the funds of the society or branch, or any part thereof, otherwise than for the purpose of carrying into effect the objects of the society or branch as declared in the rules thereof, unless the claim of every member or person claiming any relief, annuity, or other benefit from the funds thereof is first duly satisfied, or adequate provisions are made for satisfying those claims.

(5) The instrument of dissolution and all alterations therein shall be registered in manner in this Act provided for the registry of amendments of rules, and shall be binding upon all the members of the society or branch.

(6) The registrar shall cause a notice of the dissolution to be advertised at the expense of the society or branch, and unless within three months from the date of the *Gazette* in which the advertisement appears, a member or other person interested in or having any claim on the funds of the society or branch commences proceedings to set aside the dissolution of the society or branch, and the dissolution is set aside accordingly, the society or branch shall be legally dissolved from the date of that advertisement, and the requisite consents to the instrument of dissolution shall be considered to have been duly obtained without proof of the signatures thereto.

80.—(1) Upon the application made in writing under their hands—

(a) of one-fifth of the whole number of members of a registered society or branch; or

(b) in the case of a registered society or branch of one thousand members and not exceeding ten thousand, of one hundred members; or

(c) in the case of a registered society or branch of more than ten thousand members, of five hundred members,

the chief registrar may by himself, or by any assistant registrar, or by any actuary or public auditor whom the chief registrar may appoint in writing under his hand, investigate the affairs of the society or branch, but shall give not less than two months' previous notice in writing to the society or branch whose affairs are to be investigated.

(2) The application shall—

(a) state that the funds of the society or branch are insufficient to meet the existing claims thereon, or that the rates of contribution fixed in the rules of the society or branch are insufficient to cover the benefits assured; and

(b) set forth the grounds on which the insufficiency is alleged; and

(c) request an investigation into the affairs of the society or branch with a view to the dissolution thereof.

(3) If upon the investigation it appears that the funds of the society or branch are insufficient to meet the existing claims thereon, or that the rates of contribution fixed in the rules of the society or branch are insufficient to cover the benefits assured to be given by the society or branch, the chief registrar may, if he considers it expedient so to do, award that the society or branch be dissolved, and its affairs wound up, and shall direct in what manner the assets of the society or branch shall be divided or appropriated: Provided always that the chief registrar may suspend his award for such period as he may deem necessary to enable the society or branch to make such alterations and adjustment of contributions and benefits as will in his judgment prevent the necessity of the award or dissolution being made.

(4) A registrar proceeding under this section shall have all the same powers and authorities, enforceable by the same penalties, as in the case of a dispute referred to under this Act.

(5) Every award under this section, whether for dissolution or distribution of funds, shall be final and conclusive on the society or branch in respect of which the award is made, and on all members of the society or branch and on all other persons having any claim on

the funds of the society or branch, without appeal, and shall be enforced in the same manner as a decision on a dispute under this Act.

(6) The expenses of every investigation and award, and of publishing every notice of dissolution, shall be paid out of the funds of the society or branch before any other appropriation thereof is made.

(7) Notice of every award for dissolution shall, within twenty-one days after the award has been made, be advertised by the central office, and unless, within three months from the date on which that advertisement appears, a member or person interested in or having any claim on the funds of the society or branch commences proceedings to set aside the dissolution of the society or branch consequent upon such award, and the dissolution is set aside accordingly, the society or branch shall be legally dissolved from the date of the advertisement, and the requisite consents to the application to the registrar shall be considered to have been duly obtained without proof of the signatures thereto.

81.—A notice required by this Act to be advertised shall be published in the *Gazette* and in some newspaper in general circulation in the neighbourhood of the registered office of the society or branch.

82.—The provisions of this Act respecting the dissolution of societies shall not apply to any society having branches except with the consent of the central body of the society.

83.—(1) Where a person takes any proceeding to set aside the dissolution of a society or branch, he shall give notice of the proceeding to the central office not less than seven days before the proceeding is commenced.

(2) Where an order is made setting aside the dissolution of a society or branch, the society or branch shall give notice of the order to the central office within seven days after the order has been made.

Offences, Penalties, and Legal Proceedings.

84.—It shall be an offence under this Act if—

(a) a registered society or branch or an officer or member thereof fails to give any notice, send any return or document, do or allow to be done anything which the society, branch, officer or person is by this Act required to give, send, do, or allow to be done: or

(b) a registered society or branch or an officer or member thereof wilfully neglects or refuses to do any act or to furnish any information required for the purposes of this Act by the chief or other registrar or by any other person authorised under this Act, or does anything forbidden by this Act: or

(c) a registered society or branch or an officer or a member thereof makes a return or wilfully furnishes information in any respect false or insufficient: or

(d) an officer or member of a body which, having been a branch of a society, has wholly seceded or been expelled from that society thereafter uses the name of that society or any name implying that the body is a branch of that society, or the number by which that body was designated as such branch: or

(e) where a dispute is referred under this Act to the chief or other registrar, a person refuses to attend or to produce any documents, or to give evidence before the chief or other registrar: or

(f) a society or branch whether registered or unregistered pays money on the death of a child under ten years of age otherwise than is provided by this Act: or

(g) a parent or personal representative of a parent claiming money on the death of a child produces a certificate of death other than is in this Act provided to the society or branch from which the money is claimed, or produces a false certificate, or one fraudulently obtained, or in any way attempts to defeat the provisions of this Act with respect to payments upon the death of children.

85.—Where a registered society or branch is guilty of an offence under this Act every officer of the society or branch bound by the rules thereof to fulfil any duty whereof the offence is a breach, or if there is no such officer, then every member of the committee, unless that member is proved to have been ignorant of or to have attempted to prevent the commission of the offence, shall be liable to the same penalty as if he had committed the offence.

86.—Every default under this Act constituting an offence, if continued, shall constitute a new offence in every week during which the default continues.

87.—(1) If any person, with intent to mislead or defraud, gives to any other person a copy of any rules, laws, regulations, or other documents, other than the rules of a registered society or branch, on the pretence that they are the existing rules of that society or branch, or that there are no other rules of the society or branch, or gives to any person a copy of any rules on the pretence that those rules are the rules of a registered society or branch when the society or branch is not registered, the person so offending shall be guilty of a misdemeanour.

(2) If any person knowingly makes a false or fraudulent statement in any statutory declaration required by this Act, he shall be guilty of a misdemeanour.

(3) If any person obtains possession by false representation or imposition of any property of a registered society or branch, or withholds or misapplies any such property in his possession, or wilfully applies any part thereof to purposes other than those expressed or directed in the rules of the society or branch and authorised by this Act, he shall, on such complaint as is in this section mentioned, be liable on summary conviction to a fine not exceeding twenty pounds and costs, and to be ordered to deliver up all such property, or to repay all sums of money applied improperly, and in default of such delivery or repayment, or of the payment of such fine and costs as aforesaid, to be imprisoned with or without hard labour, for any time not exceeding three months.

(4) Complaint under this section may be made—

(a) in the case of a registered society, by the society or any member authorised by the society, or the trustees or committee of the society; or

(b) in the case of a registered branch, by

(i.) the branch or any member authorised by the branch or the trustees or committee thereof; or

(ii.) the central body of the society of which the branch forms part; or

(iii.) any member of the society or branch authorised by the central body; or

(c) in any case by the chief registrar or any assistant registrar by his authority, or by any member of the society or branch authorised by the central office.

(5) Nothing in this Act shall prevent any such person from being proceeded against by way of indictment, if not previously convicted of the same offence under the provisions of this Act.

88.—If any person wilfully makes, orders, or allows to be made any entry, erasure in, or omission from a Balance Sheet of a registered society or branch, or a return or document required to be sent, produced or delivered for the purposes of this Act, with intent to falsify the same, or to evade any of the provisions of this Act, he shall be liable to a fine not exceeding fifty pounds.

89.—A society or branch, and an officer or member of a society or branch, or other person guilty of an offence under this Act for which a fine is not expressly provided shall be liable to a fine of not more than five pounds.

90.—If an officer or person aids or abets in the amalgamation or transfer of engagements or in the dissolution of a friendly society otherwise than as in this Act provided he shall be liable on summary conviction to the fine imposed by this Act for offences thereunder, or to be imprisoned with hard labour for a term not exceeding three months.

91.—(1) A fine imposed by this Act, or by any regulations thereunder, or by the rules of a registered society or branch, shall be recoverable in a Court of summary jurisdiction.

(2) Any such fine shall be recoverable at the suit of the chief registrar or of any assistant registrar, or of any person aggrieved.

92.—In England and Ireland all offences and fines under this Act may be prosecuted and recovered in the manner directed by the Summary Jurisdiction Acts either—

(a) at the place where the offence was committed ; or

(b) as respects a prosecution against a registered society or branch or an officer thereof, at the place where the registered office of the society or branch is situated ; or

(c) as respects a prosecution against a person other than a registered society or branch or an officer thereof, at the place where the person is resident at the time of the institution of the prosecution.

93.—(1) In England or Ireland any person may appeal to quarter sessions from any order or conviction made by a Court of summary jurisdiction under this Act.

(2) In Scotland any person may appeal from any order or conviction under this Act in accordance with the provisions of the Summary Jurisdiction (Scotland) Acts.

94.—(1) The trustees of a registered society or branch, or any other officers authorised by the rules thereof, may bring or defend, or cause to be brought or defended, any action or other legal proceeding in any Court whatsoever, touching or concerning any property, right, or claim of the society or branch, and may sue and be sued in their proper names, without other description than the title of their office.

(2) In legal proceedings brought under this Act by a member or person claiming through a member, a registered society or branch may also be sued in the name, as defendant, of any officer or person who receives contributions or issues policies on behalf of the society or branch within the jurisdiction of the Court in which the legal proceeding is brought, with the addition of the words “on behalf of the society or branch” (naming the same).

(3) A legal proceeding shall not abate or be discontinued by the death, resignation, or removal from office of any officer, or by any act of any such officer after the commencement of the proceedings.

(4) The summons, writ, process, or other proceeding to be issued to or against the officer or other person sued on behalf of a registered society or branch shall be sufficiently served by personally serving that officer or other person, or by leaving a true copy thereof at the registered office of the society or branch, or at any place of business of the society or branch within the jurisdiction of the Court in which the proceeding is brought, or, if that office or place of business is closed, by posting the copy on the outer door of that office or place of business.

(5) In all cases where the said summons, writ, process, or other proceeding is not served by means of such personal service or by leaving a true copy thereof at the registered office of the society or branch as aforesaid, a copy thereof shall be sent in a registered letter addressed to the committee at the registered office of the society or branch, and posted at least six days before any further step is taken on the proceeding.

Application of Act.

101.—(1) This Act shall apply to societies and branches subsisting at the commencement of this Act which or the rules of which have been registered, enrolled, or certified under any Act relating to friendly societies or cattle insurance societies, as if they had been registered under this Act, and the rules of those societies and branches shall, so far as they are not contrary to any express provision of this Act, continue in force until altered or rescinded.

(2) Where the contingent annual payments to which the members or the nominees of the members of friendly societies or branches, established before the fifteenth day of August one thousand eight hundred and fifty, may become entitled exceed the limit fixed by this Act, the rules of those societies and branches shall continue to be valid, anything in this Act to the contrary notwithstanding.

102.—In the application of this Act to Scotland :—

The expression “land” shall include heritable subjects of whatever description ;

The expressions “Court of summary jurisdiction” and “County Court” shall mean the Sheriff Court of the county ;

The expression “administration” shall mean confirmation ;

The expression “misdemeanour” shall mean crime and offence.

103.—This Act shall apply to the Isle of Man as if it were part of England, subject to the following variations:—

(1) The expressions “Supreme Court” and “County Court” shall respectively mean the Chancery Division of the High Court of the said isle, in which Court the proceedings under this Act may be regulated by rules and orders to be made in that behalf by the Court, and, until otherwise provided, shall be regulated according to the ordinary practice of that Court.

(2) The expression “the Companies Acts 1862 to 1890” shall mean the law for the time being in force in the said isle for the regulating and winding-up of companies.

(3) The expression “Summary Jurisdiction Acts” shall mean the laws for the time being in force in the said isle for regulating the exercise of summary jurisdiction by justices of the peace.

(4) All offences and fines under this Act shall be prosecuted and recovered summarily before a high bailiff or two justices of the peace at the suit or instance, except in the case of a complaint under section eighty-seven of this Act, of a registrar or of a head constable, and a misdemeanour under this Act shall be punishable by fine or imprisonment.

(5) All fines recovered under this Act shall be paid to the treasurer of the said isle, and be added to the general revenue of the said isle.

(6) A person may appeal from any order or conviction to be made in a case of summary jurisdiction under this Act in the manner prescribed by the law in force in the said isle as to appeals in cases of summary jurisdiction.

104.—This Act shall apply to the Channel Islands as if they were part of England, subject to the following variations:—

(1) As respects the Island of Jersey:

(a) The expression “County Court” shall mean the Court for the recovery of petty debts, in all cases in which the claim or demand shall not exceed the sum of ten pounds sterling, and in all other cases the inferior number of the Royal Court of the said island, composed of the bailiff and two jurats of the said Court:

(b) The expression “Court of Summary Jurisdiction” shall have in civil cases the same meaning as the expression County Court:

(c) All misdemeanours under this Act shall be prosecuted, tried and punished in the form and manner prescribed by the law and custom of the said island with respect to crimes and offences (*crimes et délits*):

(d) All other offences and all fines under this Act shall be prosecuted and recovered summarily before the magistrate of the Court for the repression of minor offences, in all cases of his competency, at the suit or instance, except in the case of a complaint under section eighty-seven of this Act, of the constable of the parish in which the offence or other unlawful act has been committed, and in all other cases before the bailiff and two jurats of the Royal Court, at the suit or instance (except as aforesaid) of Her Majesty's Procurator-General for the said island :

(e) All fines recovered under this Act shall be paid to the officers who by the law and practice of the said island are entitled to receive fines levied by order of the said Courts respectively, and shall by such officers be accounted for and paid to Her Majesty's Receiver-General in the said island on behalf of the Crown :

(f) All proceedings under this Act in any of the Courts of the said island shall be regulated according to the ordinary practice of those Courts respectively, and all fines shall in default of payment be enforced in the same manner as fines payable to the Crown in the said island :

(g) The rules prescribed by the law of the said island with respect to appeals in civil and criminal cases shall be followed as to appeals from any orders, judgments, or convictions made in cases of summary jurisdiction under this Act :

(h) The expression "the Companies Acts 1862 to 1890" shall mean the law for the time being in force in the said island for the formation, regulation, and winding-up of companies :

(i) All friendly societies and branches within the bailiwick of the said island may invest any part of their funds in any of the public funds under the guarantee of the states of the said island.

(2) As respects the bailiwick of the Island of Guernsey :

(a) The Court of Primary Instance within the bailiwick shall have all such powers and authorities as are by this Act conferred either on Courts of summary jurisdiction or on County Courts in England : Provided that a sentence may be appealed from if the case admits of an appeal under the Orders in Council now in force within the bailiwick, but that the decision of the Royal Court when sitting in a body as a Court of Appeal shall be final :

(b) All friendly societies and branches within the bailiwick shall be authorised to invest any part of their funds in the State bonds either of Guernsey or of Alderney :

(c) The expression "the Companies Acts 1862 to 1890" shall mean the law for the time being in force in the said bailiwick for the regulation and winding-up of companies :

(d) All offences and fines under this Act shall be prosecuted and recovered summarily before the Court of primary jurisdiction at the suit or instance, except in the case of a complaint under section eighty-seven of this Act, of the law officers of the Crown, or of a constable of a parish :

(e) All fines recovered under this Act shall be paid to the Receiver-General, to be by him carried to the account of the Crown Revenue.

105.—As respects the Channel Islands and the Isle of Man, when any sum of money becomes payable on the death of a person entitled to make a nomination under this Act that sum shall, in default of any such nomination, be paid to the deceased member's legal representative, according to the law of the island in which that deceased member was domiciled.

Supplemental.

106.—In this Act, unless a contrary intention appears :

The expression "the registrar" shall mean for England the central office, and for Scotland or Ireland the assistant registrar for Scotland or Ireland :

The expression "land" shall include any interest in land :

The expression "property" shall extend to all property whether real or personal (including books and papers) :

The expression "registered society" shall mean a society registered under this Act, and shall include societies subsisting at the commencement of this Act to which the provisions of this Act apply :

The expression "amendment of rule" shall include a new rule, and a resolution rescinding a rule :

The expression "branch" shall mean any number of the members of a society, under the control of a central body, having a separate fund, administered by themselves or by a committee or officers appointed by themselves, and bound to contribute to a fund under the control of a central body :

The expression "committee" shall mean the committee of management or other directing body of a society or branch :

The expression "persons claiming through a member" shall include the nominees of the member where nomination is allowed :

The expression "officer" shall include any trustee, treasurer, secretary, or member of the committee of management of a society or branch,

or person appointed by the society or branch to sue and be sued on its behalf:

The expression "meeting" shall include (where the rules of a society or branch so allow) a meeting of delegates appointed by members:

The expression "gazette" shall mean the London Gazette for England, the Edinburgh Gazette for Scotland, and the Dublin Gazette for Ireland:

The expression "Treasury regulations" shall mean any regulations made and approved by the Treasury and in force under this Act.

107.—The Acts mentioned in the Third Schedule to this Act are hereby repealed to the extent mentioned in the third column of that schedule.

108.—This Act shall come into operation on the first day of January next after the passing thereof and shall extend to the whole of the British Islands.

109.—This Act may be cited as the Friendly Societies Act 1896.

SCHEDULES.

THE FIRST SCHEDULE.

Matters to be provided for by the Rules of Societies registered under this Act.

1. The name and place of office of the society.
2. The whole of the objects for which the society is to be established, the purposes for which the funds thereof shall be applicable, the terms of admission of members, the conditions under which any member may become entitled to any benefit assured thereby, and the fines and forfeitures to be imposed on any member, and the consequences of non-payment of any subscription or fine.
3. The mode of holding meetings and right of voting, and the manner of making, altering, or rescinding rules.
4. The appointment and removal of a committee of management (by whatever name), of a treasurer and other officers, and of trustees, and in the case of a society with branches, the composition and powers of the central body, and the conditions under which a branch may secede from the society.

5. The investment of the funds, the keeping of the accounts, and the audit of the same once a year at least.

6. Annual returns to the registrar of the receipts, funds, effects, and expenditure and number of members of the society.

7. The inspection of the books of the society by every person having an interest in the funds of the society.

8. The manner in which disputes shall be settled.

9. In case of dividing societies, a provision for meeting all claims upon the society existing at the time of division before any such division takes place.

And also in the case of friendly and cattle insurance societies:—

10. The keeping separate accounts of all moneys received or paid on account of every particular fund or benefit assured for which a separate table of contributions payable shall have been adopted, and the keeping separate account of the expenses of management, and of all contributions on account thereof.

11. (Except as to cattle insurance societies) a valuation once at least in every five years of the assets and liabilities of the society, including the estimated risks and contributions.

12. The voluntary dissolution of the society by consent in a friendly society of not less than five-sixths in value of the members, and of every person for the time being entitled to any benefit from the funds of the society, unless his claim be first satisfied or adequately provided for; and in a cattle insurance society by consent of three-fourths in numbers of the members.

13. The right of one-fifth of the total number of members, or of one hundred members in the case of a society of one thousand members and not exceeding ten thousand, or of five hundred members in the case of a society of more than ten thousand members, to apply to the chief registrar, or in the case of societies registered and doing business exclusively in Scotland or Ireland to the assistant registrar for Scotland or Ireland, for an investigation of the affairs of the society, or for winding up the same.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR.

The principal points to be attended to in filling up the Return are:—

1. Receipts and Expenditure. It must be carefully remembered that this is not a mere Cash Account, giving particulars of cash received and cash expended. Accordingly, such items as—

(a) Cash withdrawn from bank or cash paid into bank,

(b) Cash expended in purchase of investments or cash received on sale of investments, or on discharge of mortgages, &c., &c.,

must not appear beyond entering as a profit or loss, as the case may be, the difference between the amount received and the amount at which the asset previously stood in the society's Balance Sheet.

2. Interest on the funds which have become due and payable in the course of the year should appear as a receipt, and if not actually paid at end of year will appear in the assets of the Balance Sheet as interest due and unpaid.

3. Where under the rule separate funds are required to be kept for the various benefits, the amounts of these various funds should always be stated separately in the Balance Sheet (Form B), *the total amount of funds agreeing with that stated under Receipts and Expenditure Account.*

4. Where any particular fund has no assets, but is indebted for the time being to other funds, the amount of such indebtedness, clearly described, must appear under "Other Assets," and when a deficiency in any fund exists, both at the beginning and end of the year, the amount of such deficiency at the beginning of the year must be stated below the item "Amount of funds at end of the year, as per Balance Sheet," and the amount of such deficiency at the end of the year below the item "Amount of funds at beginning of the year," in each case being clearly described.

5. The amount of benefit (or management) fund (or funds) brought forward at beginning of year must agree with corresponding amounts at close of the previous year.

6. Whatever the rules may provide as to date of annual meeting and annual accounts, the annual return required under the Act to be made and sent to the registrar must always be made up for the year ending 31st December.

7. The amount of contributions received in the course of the year in respect of any particular fund should be so entered as to include contributions remaining unpaid at 31st December, but not in arrear to the extent of forfeiture of membership, and this latter should appear as "contributions in arrear" among the assets of the Balance Sheet, and would consequently not be included in the item "contributions" for the next year.

8. Unless the auditor is one of the public auditors appointed by the Lords of the Treasury under the Act, the annual return must be signed

by at least two auditors appointed under the society's rules, as well as by the officers specified.

9. That each account be correctly added up.

10. The totals at the bottom, on the opposite sides of each account, to be the same.

11. That the funds of the society are invested in strict accordance with the registered rules of the society. The investment of moneys on notes of hand and other personal securities is not legal.

12. That all receipts and expenditure outside the objects of the society, such as for banners, fêtes, anniversaries, &c., be not included in the return.

Societies are reminded that the valuations under the Act must be sent to the Registrar once at least in every five years. (See section 14 (1) (f) of the 38 & 39 Vict. c. 60.)

[Fill up the blank lines with Name, Registered Office and Registered
Number of the Society.]

Name of Society _____

Registered Office of Society _____

in the County of _____ Register No. _____

Received a document purporting to be the Annual Return of the Society
for the year 1894.

N.B.—On receipt with the return of an envelope of sufficient size, written on the top "*On Her Majesty's Service*," directed as the society may desire, the above acknowledgment (which is not to be taken as implying that a valid return has been received) will be forwarded.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—continued.

FORMS A AND B.

RETURN REQUIRED FROM A REGISTERED SOCIETY.

(Not being a collecting Society within s. 30 of the Act.)
Year ending 31st December 1894.

[The Society's Balance Sheet cannot be accepted as a substitute for this Return.]

This Return is to be sent to the Registrar before the 1st of June 1895.

A copy of the Auditor's Report, if any, should also be sent.

This portion is to be filled up whether form A or form B is adopted.

Name of Society
Register No.
Date of Commencement of Society 18 ..
When first Enrolled, Certified, or Registered
Names of the present Trustees
Name and address of the Treasurer and of any
other Officer in receipt or charge of money }
Amount of Security given by him or them £

Number of benefit members at the beginning of the year
Number of benefit members admitted during the year
Together
Number of benefit members who died during the year .. }
Number of benefit members who left from other causes .. }
Total number of benefit members at the end of the year

Average amount of Funds per member (that is, the total funds on
the 31st December 1894, divided by the total number of benefit
members) £
State what provision, if any, is made for old age
The Audit for the year has been conducted by Mr. , Public
Auditor,* [or by of
whose calling or profession is , and
of , whose calling or profession
is who were appointed Auditors by
under the authority of Rule No.].
Registered Office of the Society† in the county of
Date 1895.

* This term means only a Public Auditor appointed under the Friendly Societies Acts.
† State full postal address.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—continued.

FORM A.

For Societies whose Members pay only one Contribution for all Benefits.

RECEIPTS.		EXPENDITURE.	
BENEFIT FUND.		BENEFIT FUND.	
	£ s d		£ s d
[If for more than one purpose, state on separate lines the amount raised for each]	Contributions	weeks pay to members on full	
	Levies (if any)	pay (lasting by rules	
		weeks pay to members on	
		reduced pay (1st period, lasting	
		weeks pay to members on	
		reduced pay (2nd period, lasting	
		weeks) (e)	
		of members and children of members	
		above 10 years of age	
		of wives [or husbands] of members	
		of children under 5 years of age	
		of children between 5 and 10 years of age	
(a) Specify their nature	Fines (not appropriated to Management Fund)	Cost of medical aid (if not paid out of Management Fund)	
	Entrance Fees (not appropriated to Management Fund)	Payments for other benefits (if any) (f)	
	Interest on Investments of Benefit Fund	Other Payments (if any) (g)	
	Other Receipts (a)	Total Expenditure	
	Total Receipts	Amount of Benefit Fund at the end of the year, as per Balance Sheet (below)	
	Amount of Benefit Fund at the beginning of the year		
	Total	Total	

(e) If any further reductions they should be stated separately

(f) State separately the expenditure for each

(g) Specify their nature

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—FORM A—continued.

MANAGEMENT FUND.*

RECEIPTS.		EXPENDITURE	
	£ s d		£ s d
Members to this Fund	Salaries ..	..
for Management	Rent ..	..
Management	Printing, Stationery, and Postage ..	..
..	..	Other Payments (if any) (h) ..	..
Fund by the Society's Rules if Management Fund
..	..	Total Expenses of Management ..	..
..	..	Bad Debts and Losses ..	..
Contributions for Medical Aid	Cost of Medical Aid ..	..
			..
Total Receipts	Total Expenditure ..	..
Amount of Management Fund at the beginning of the year	Amount of Management Fund at the end of the year, as per Balance Sheet (below) ..	..
..
Total ..	£	Total ..	£

* If the Society was registered before 23rd July 1855, and has no separate Management Fund provided for in its rules, state the fact.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—*continued.*

EXTRACTS FROM 38 AND 39 VICT. C. 60.

Duties and obligations of societies.

14.—With respect to the duties and obligations of registered societies the following provisions shall have effect:—

(1) Every registered society shall—

Audit.

(c) Once at least in every year submit its accounts for audit either to *one of the public auditors* appointed as herein mentioned, or to *two or more persons appointed as the rules of the society provide*, which auditors shall have access to all the books and accounts of the society, and shall examine the general statement of the receipts and expenditure, funds and effects of the society, and verify the same with the accounts and vouchers relating thereto, and shall either sign the same as found by them to be correct, duly vouched, and in accordance with law, or specially report to the society in what respects they find it incorrect, unvouched, or not in accordance with law.

Annual returns.

(d) Once in every year before the first day of June send to the registrar a general statement (to be called the annual return) of the receipts and expenditure, funds and effects of the society *as audited*, which shall show separately the expenditure in respect of the several objects of the society, and shall be made out to the thirty-first December then last inclusively, and a copy of the auditor's report, if any, shall also be sent to the registrar with such general statement; and such annual return shall state whether the audit has been conducted by a public auditor appointed as in this Act provided, and by whom; and, if by any person or persons other than a public auditor, shall state the name, address, and calling or profession of each of such persons, and the manner in which, and the authority under which, they were respectively appointed.

Supplying copies of annual returns.

(h) Supply gratuitously every member or person interested in the funds of the society, on his application, with a copy of the last annual return of the society for the time being. Provided that it shall be deemed a sufficient compliance with this requirement if

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—*continued*.

the society supplies gratuitously every member or person interested with a Balance Sheet or other document, duly audited, containing the same particulars as to the receipts and expenditure, funds and effects of the society as are contained in the annual return.

- (i) Keep a copy of the last annual Balance Sheet for the time being, and of the last quinquennial valuation for the time being, together with the report of the auditors, if any, always hung up in a conspicuous place at the registered office of the society.

Offences.

(3) It shall be an offence under this Act if any registered society or any officer or member thereof—

- (a) *Fails* to give any notice, *send any return* or document, or do or allow to be done, any act or thing which the society, officer, or person is by this Act required to give, send, do, or allow to be done.
- (b) Wilfully neglects or refuses to do any act, or to furnish any information required for the purposes of this Act by the chief or any other registrar, or other person authorised under this Act, or does any act or thing forbidden by this Act.
- (c) *Makes a return*, or wilfully furnishes any information, in any respect *false or insufficient*.

Offence by societies to be also offences by officers, &c

(4) Every offence by a society under this Act shall be deemed to have been also committed by every officer of the same bound by the rules thereof to fulfil any duty whereof such offence is a breach, or if there be no such officer, then by every member of the committee of management of the same, unless such member be proved to have been ignorant of or to have attempted to prevent the commission of such offence; and every default under this Act constituting an offence, if continued, constitutes a new offence in every week during which the same continues.

Returns to be in prescribed form.

(5) Every *annual or other return*, abstract of valuation, and other document required for the purposes of this Act, *shall be made in such form*, and shall contain such particulars, *as the chief registrar prescribes*.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—*continued.**Penalties.*

32.—With respect to penalties under this Act, the following provisions shall have effect :—

Penalty for falsification.

(1) If any person wilfully makes, orders, or allows to be made, any entry, erasure in, or omission from any Balance Sheet of a registered society, or any contribution or collecting book, or any return or document required to be sent, produced or delivered for the purposes of this Act, with intent to falsify the same, or to evade any of the provisions of this Act, he is liable to a penalty not exceeding fifty pounds, recoverable at the suit of the chief or any assistant registrar, or of any person aggrieved.

Penalties for ordinary offences.

(2) Every society, officer, or member of a society, or other person guilty of an offence under this Act for which no penalty is expressly provided herein is liable to a penalty of *not less than one pound*, and not more than five pounds, recoverable at the suit of the chief or any assistant registrar, or of any person aggrieved.

Recovery of Penalties.

(3) All penalties imposed by this Act, or to be imposed by any regulations under the same, or by the rules of a registered society, are recoverable in a Court of summary jurisdiction.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—FORM B—continued.

MANAGEMENT FUND.*

RECEIPTS.		EXPENDITURE.	
(d) Specify their nature.	£ s d	£ s d	(i) Specifying their nature.
Donations of Honorary Members appropriated to this Fund	Salaries .. .. .	.. .. .
Contributions of Members for Management	Rent .. .. .	.. .. .
Levies upon Members for Management	Printing, Stationery, and Postages .. .. .	.. .. .
his Fund by the Society's	Other Payments (if any) (i) .. .. .	.. .. .
f Management Fund	Total Expenses of Management .. .. .	.. .. .
Aid	Bad Debts and Losses .. .. .	.. .. .
Total Receipts	Cost of Medical Aid .. .. .	.. .. .
Amount of Management Fund at the beginning of the year	Total Expenditure .. .. .	.. .. .
..	Amount of Management Fund at the end of the year, as per Balance Sheet (below) .. .. .	.. .. .
Total	£	Total	£

* the Society was registered before 23rd July 1855, and has no separate Management Fund provided for in its rules, state the fact.

ANNUAL RETURN AS PRESCRIBED BY THE CHIEF REGISTRAR—FORM B—continued.

BALANCE SHEET OF FUNDS AND EFFECTS.

Cr.

Dr.

Dr.		£ s d	Cr.		£ s d
INVESTMENTS					
(e) Where a single contribution provides more than one benefit, the lines may be bracketed together	Amount of Sickness Fund (e) .. .. .	.. .. .	1. In the Savings Bank, interest at per cent		
	Amount of Death Fund .. .. .	.. .. .	2. In the Public Funds (m)		
	Amount of Annuity Fund .. .. .	.. .. .	3. With the Commissioners for the reduction of the National Debt, interest at per cent.		
	Amount of Endowment Fund .. .. .	.. .. .	4. Upon Government Securities in Great Britain or Ireland, interest at per cent.		
	Amount of Old Age Fund (where separate) .. .. .	.. .. .	5. Upon Real Securities in Great Britain or Ireland, interest at an average of per cent.		
	Amount of Widows and Orphans' Fund (where separate) .. .. .	.. .. .	6. In the Purchase of Land		
	Amount of Lying-in Fund (where separate) .. .. .	.. .. .	7. In the Erection of Offices and Buildings		
	Amount of A .. .. .	.. .. .	8. In Loans on Members' Assurances, under s. 18 (1) per cent.		
	Amount of T .. .. .	.. .. .	9. In per cent.		
	Amount of Y .. .. .	.. .. .	10. On per cent.		
	Amount of Surplus Fund accumulated for Members' use under s. 19 of Act .. .. .	.. .. .	Cash in the Post Office Savings Bank		
(f) Specify their nature.	Amount of separate Loan Fund under s. 18 (2) of Act .. .. .	.. .. .	Cash in hand (p)		
	Amount of .. .. .	.. .. .	Other Assets (if any) (p)		
	Amount of .. .. .	.. .. .	Total	£	
(g) Specify them.	Amount of Management Fund (as above) .. .. .	.. .. .		
	Debts (if any) (f) legally incurred by Trustees on behalf of the Society .. .. .	.. .. .		
	Cash due to Treasurer (if any) .. .. .	.. .. .		
	Other Liabilities (if any) (g) .. .. .	.. .. .		
	Total	£			

(m) State amount and description of stock.

(n) State them separately.

(o) State in whose hands.
(p) Specify them

* State Postal Address.

Signature of Treasurer or one of the Trustees Signature of Secretary reading at

The undersigned, having had access to all the Books and Accounts of the Society, and having examined the foregoing General Statement, and verified the same with the Accounts and Vouchers relating thereto, now sign the same as found to be correct, duly vouched, and in accordance with law.

* Public Auditor: or Auditors Date 1895.

* This term means only a Public Auditor appointed under the Friendly Societies Act.

If in any respect these accounts are incorrect, unvouched, or not in accordance with law, the Auditors are not to sign as above, but are to make a special report to the Society, of which a copy is to be sent to the Registrar with this Statement.

TRUSTEE SAVINGS BANKS.**THE TRUSTEE SAVINGS BANKS ACT 1863.**

26 and 27 Vict. c. 87.

No savings bank, subject to proviso hereinafter contained with respect to branch offices, etc., shall have benefit of this Act unless in rules, etc., it shall be expressly provided as herein specified.

6.—No savings bank, subject to the proviso hereinafter contained with respect to the branch offices or local receivers of any savings bank, shall have the benefit of this Act unless in the rules and regulations for the management thereof it shall be expressly provided,—

(1) That no person or persons being treasurer, trustee, or manager of such savings bank, or having any control in the management thereof, shall derive any benefit from any deposit made in such savings bank, save only and except such salaries and allowances or other necessary expenses as shall according to such rules and regulations be provided for the charges of managing such savings bank, and for remuneration to officers employed in the management thereof, exclusive of the treasurer or treasurers, trustee or trustees, manager or managers, or other persons having direction in the management of such savings bank, who shall not directly or indirectly have any salary, allowance, profit, or benefit whatsoever therefrom beyond their actual expenses for the purposes of such savings bank :

(2) That not less than two persons, being either trustees, managers, or paid officers appointed for that specific purpose, and where two only, except in the case of savings banks which are open for more than six hours in every week, one such person to be a trustee or manager, be present on all occasions of public business, and be parties to every transaction of deposit and repayment, so as to form at least a double check on every such transaction with depositors :

(3) That the depositor's Pass Book shall be compared with the Ledger on every transaction of repayment. and on its first production at the bank after each twentieth day of *November* :

(4) That every depositor in a savings bank established under this Act shall once at least in every year cause his deposit book to be produced at the office of the said savings bank for the purpose of being examined :

(5) That no money be received from or paid to depositors except at the office or branch offices where the business of the savings bank is carried on under the authority of the board of managers, and during the usual hours for public business :

(6) That a public accountant or one or more auditors be appointed by the trustees and managers, but not out of their own body, to examine the books of the bank, and to report in writing to the board or committee of management the result of such audit, not less than once in every half-year, also to examine an extracted list of the depositor's balances made up every year to the twentieth day of *November*, and to certify as to the correct amount of the liabilities and assets of the bank :

(7) That a book containing such extracted list of every depositor's balance, omitting the name, but giving the distinctive number and separate amount of each, and showing the aggregate number and amount of the whole, checked and certified by such public accountant or auditors, be open at any time during the hours of public business for the inspection of every depositor as respects his own account, to examine his own deposit book therewith, and the general results of the same :

(8) That the trustees and managers or committee of management shall hold meetings once at least in every half-year, and shall keep minutes of their proceedings in a separate book provided for that purpose :

Proviso with respect to branch offices and local receivers of banks.

(9) Provided that where savings banks are established with agents or local receivers elsewhere than at the head office, the rules shall provide for the due receipt of, and accounting for, all moneys by such agents or local receivers on account of such savings banks respectively, and also for the presence of a second party in every transaction when money is paid or received, and also for the periodical examination of the depositors' books with the Ledger once at least in every year.

Weekly returns to be made by savings banks to the Commissioners.

7.—The trustees and managers of every savings bank shall transmit weekly returns to the Commissioners for the Reduction of the National Debt, in such form and giving such particulars as the said Commissioners may direct, showing the amounts of the week's transactions of such savings bank, and the amount of the cash balances remaining in the hands of the treasurer or any other person on account of such savings bank.

Trustees of savings banks shall invest all money in the Banks of England or Ireland and not in any other security.

15.—The several sums of money belonging to any savings bank which the trustees of such savings bank respectively are authorised to invest under this Act or under any rules or regulations of any such savings bank shall, except as hereinafter is excepted, be paid into and vested in the Bank of *England* or the Bank of *Ireland*, as the case may require, in the names of the Commissioners for the Reduction of the National Debt according to the provisions of this Act, enabling such trustees to make investments in the names of the said Commissioners, and no such sum or sums shall be paid or laid out by the trustees of such savings bank in any other manner or upon any other security whatever, except as aforesaid, and except such sums of money as from time to time shall necessarily remain in the hands of the treasurer or treasurers of such savings bank to answer the exigencies thereof: Provided always, that nothing herein contained shall restrain or prevent any depositor, or any trustee or trustees acting on behalf of any depositor or depositors, or any friendly society, or any charitable or provident institution or society, or penny savings bank, from withdrawing from any such savings bank any sum or sums of money which shall have been deposited by such depositor, friendly society, charitable or provident institution or society, or penny savings bank, and investing the same in any other securities: Provided always, that the trustees of any savings bank already established, or which shall take the benefit of this Act in manner hereinbefore provided, shall be and they are hereby empowered to pay into the Bank of *England* or *Ireland* (as the case may be) any sum or sums of money, not being less than fifty pounds, to the account of the Commissioners for the Reduction of the National Debt, upon the declaration of the trustees of such savings bank, or any two or more of them, that such moneys belong exclusively to the savings bank for which such payment is intended to be made, whether such moneys shall have been deposited therein before the passing of this Act or thereafter shall be deposited therein, and the cashier or cashiers of the Banks of *England* and *Ireland* respectively are hereby required to receive all such moneys, and to place the same into the account raised in the names of the said Commissioners in the books of the Banks of *England* and *Ireland* respectively, denominated "The fund for the banks for savings": Provided, nevertheless, that previous to any payment being made into the Banks of *England* or *Ireland* as aforesaid, the person or persons applying for that purpose shall in all cases produce to the officer of the said Commissioners, at their office in *London* or *Dublin* (as the case may be), an order under the hands of two of the trustees of such savings banks on the account of which such payment is to be made.

Trustees not to receive from any one depositor more than £30 in any one year.

39.—It shall not be lawful for the trustees of any savings bank to receive from any one present or future depositor, within any one year ending on the twentieth day of November whether any sum or sums of money had been previously withdrawn or not, any sum or sums exceeding in the whole thirty pounds, exclusive of compound interest.

Not to affect deposits of £200 on the 28th July 1828.

Provided that nothing in this Act contained shall prevent or be construed to prevent the trustees of any savings bank from paying interest to any depositor whose deposit on the twenty-eighth day of July one thousand eight hundred and twenty-eight amounted to and has since continued to amount to or exceed the sum of two hundred pounds :

Depositors not prevented from becoming new depositors.

nor to prevent any depositor, having closed his or her account in any savings bank, from making a deposit in the same or any other savings bank, not exceeding the limit allowed to be received in any one year from any new depositor.

Appointment of Auditors in Ireland.

51.—The trustees of each savings bank in *Ireland* shall, as soon as conveniently may be after the passing of this Act, and from time to time in case of a vacancy, appoint an auditor or auditors to audit the accounts of the said savings bank, as well as to examine and inspect the books of the several depositors, and the said trustees shall, immediately after such appointment, transmit the signature, name, and address of the said auditor or auditors to the Commissioners for the Reduction of the National Debt ; and the trustees of every such savings bank in *Ireland* shall cause the annual and other statements required to be transmitted under this Act to be certified and verified by the auditor or auditors appointed by the said trustees, in addition to the attestation by trustees and managers, as also required by this Act, and shall also cause a certificate from the said auditor or auditors, as to the result of his or their examination of such of the depositors' books as may have been produced to him or them for examination, to be transmitted with the said annual statement to the said Commissioners : provided always that it shall be lawful for the trustees of any such savings bank in *Ireland* to agree with the trustees of any other such savings bank or banks in *Ireland* as to the appointment of a common auditor or auditors, and the auditor or auditors so appointed for all the

said banks shall be deemed and taken, as soon as the signature, name, and address shall have been transmitted by each such bank to the said Commissioners, to be the auditor or auditors of each such bank.

Trustees of savings banks shall make up annually accounts of their progress, etc., and transmit the same to the Commissioners for Reduction of the National Debt.

55.—For the more effectual ascertaining from time to time the actual and progressive state of the several savings banks enrolled under the provisions of this Act, the trustees and managers of every such savings bank shall annually cause a general statement of the funds of such savings bank invested in the Bank of *England* or the Bank of *Ireland* in the names of the Commissioners for the Reduction of the National Debt to be prepared up to the twentieth day of *November* in each year, showing the balance or principal sum due to all the depositors collectively in such savings bank, and a statement of the expenses incurred, and stating in whose hands such balance shall then be remaining; and every such annual statement shall be attested by two managers or two trustees, or by one manager and one trustee of such savings bank, and every such annual statement shall be countersigned by the secretary or actuary of such savings bank, and all such annual statements shall be transmitted to the office of the said Commissioners for the Reduction of the National Debt in *London* or *Dublin* (as the case may be) within nine weeks after the twentieth day of *November* in each year.

If trustees neglect to transmit such accounts, or to obey any orders given pursuant to this Act, Commissioners may close their accounts, etc.

And in case the trustees of any such savings bank shall neglect or refuse to make out and transmit such accounts as aforesaid, or in case any such trustees shall at any time neglect or refuse to obey any orders or directions given by the said Commissioners or through their officer, pursuant to the directions of this Act, it shall be lawful for the said Commissioners to close the account of the trustees of such savings bank, and to discontinue the keeping of any further account with the trustees of such savings bank, and to direct that no further sum shall be received at the Bank of *England* or at the bank of *Ireland* from the trustees of such savings bank to the account of the said Commissioners until such time as such Commissioners shall think fit: Provided always that it may be lawful for the said Commissioners to re-open such account, and to allow the growing interest of such account during the time of such discontinuance, and to authorise the receipt of money at the Bank of *England* or *Ireland*, whenever such Commissioners shall think fit to do so, upon such trustees complying with the directions of such Commissioners or their officer.

A duplicate of such account shall be affixed in the office of the savings bank.

59.—The trustees and managers of every such savings bank shall cause a duplicate of every such annual statement, accompanied by a list of the trustees and managers of such institution for the time being, attested and countersigned as aforesaid, to be publicly affixed and exhibited in some conspicuous part of the office or place where the deposits of such savings bank are usually received, for the information of all parties making deposits therein; and every such duplicate shall from time to time remain so affixed and exhibited until the ensuing annual statement shall in like manner be affixed and exhibited as aforesaid; and every depositor shall be entitled to receive from the said savings bank a printed copy of such annual statement on payment of one penny.

Savings banks shall compute interest on 20th May and 20th November, half-yearly or yearly.

62.—For the purpose of rendering the accounts of the several savings banks in *Great Britain* and *Ireland* uniform and correspondent with the accounts of the Commissioners for the Reduction of the National Debt, the interest payable to the depositors in such savings banks in *Great Britain* and *Ireland* shall, from and after the twentieth day of *November* one thousand eight hundred and sixty-three, be computed half-yearly to the twentieth day of *May* and the twentieth day of *November*, or yearly to the twentieth day of *November* in each year, as the case may be, and to no other periods.

THE SAVINGS BANKS ACT 1891.

55 and 56 Vict. c. 21.

Establishment of inspection committee.

2.—(1) There shall be established an inspection committee of trustee savings banks.

Powers and duties of inspection committee.

3.—(4) The trustees of every trustee savings bank shall, on the requisition of the committee, supply the committee with a copy of the Pass Book in use in the bank, of the annual general statement of the accounts of the bank, and of the rules of the bank, and of any amendments thereof.

(5) If in the opinion of the committee the rules of any such bank are insufficient for the purpose of maintaining an efficient audit, the bank shall with all convenient speed make such additional rules as may, in the opinion of the committee, be required for the purpose.

(6) If the bank do not, within a time specified by the committee from the date of being required to make any such rules, comply with the requirement, the committee may make such rules, and shall submit the rules so made to the Registrar of Friendly Societies, to be certified by him; and, when so certified, they shall be binding on the trustees.

Form of annual statement by trustees of trustee savings banks.

8.—The annual statement required by section fifty-five of the Trustee Savings Banks Act 1863 to be made by the trustees and managers of every trustee savings bank shall be in such form and contain or be accompanied by such particulars as the National Debt Commissioners direct. A similar statement shall be sent to the inspection committee each year at the same time.

Amendment of law as to limit of deposit and interest on deposit.

11.—Whereas it is not lawful for the trustees of a savings bank or for the Postmaster-General to receive from any depositor any sum which shall make the sum to which such depositor shall be entitled exceed the sum of one hundred and fifty pounds in the whole exclusive of interest, but the sum standing in the name of any depositor may be increased by accumulations of interest to any sum not exceeding two hundred pounds in the whole, and difficulties have arisen in the due apportionment between principal and interest of sums standing to the credit of depositors in excess of one hundred and fifty pounds; be it therefore enacted as follows:—

(1) A savings bank shall not receive any deposit which makes the sum standing in the name of any depositor in the bank exceed two hundred pounds.

(2) So much of any enactment as prohibits the receipt from any depositor of any sum of money which makes the sum to which he is entitled exceed the sum of one hundred and fifty pounds in the whole, exclusive of interest, is hereby repealed.

(3) Interest shall be allowed in full on the sum standing in the name of a depositor in a savings bank so long as it does not exceed two hundred pounds, but whenever the sum standing in the name of any depositor in any savings bank exceeds that amount, interest shall not be allowed on any sum in excess of two hundred pounds.

(4) Notwithstanding any restriction on the amount to be deposited in any one year, a depositor in a savings bank may, not more than once in any savings bank year, deposit money to replace money previously withdrawn in one entire sum during that year. For the purposes of this provision the expression "savings bank year" means, with reference to trustee savings banks, the year ending the twentieth day of November, and with reference to the Post Office savings banks, the year ending the thirty-first day of December.

CO-OPERATIVE ACCOUNTS, &c.

THE INDUSTRIAL AND PROVIDENT SOCIETIES ACT 1893.

56 and 57 Vict. c. 39.

13.—(1) Every registered society shall, once, at least, in every year, submit its accounts for audit, either to one of the public auditors in the Act mentioned, or to two or more persons appointed as the rules of the society provide.

(2) The auditor shall have access to all the books, deeds, documents, and accounts of the society, and shall examine the Balance Sheets, showing the receipts and expenditure, funds and effects of the society, and verify the same with the books, deeds, documents, accounts, and vouchers relating thereto, and shall either sign the same as found by them to be correct, duly vouched, and in accordance with law, or specially report to the society in what respects they find them incorrect, unvouched, or not in accordance with law.

Annual returns.

14.—(1) Every registered society shall, once in every year, not later than the thirty-first day of March, send to the registrar an annual return of the receipts and expenditure, funds and effects, of the society as audited.

(2) The annual return—

(a) Shall be signed by the auditor or auditors; and

(b) Shall show separately the expenditure in respect of the several objects of the society; and

- (c) Shall be made out from the date of its registration or last annual return to that of its last published Balance Sheet, provided that the last-named date is not more than one month before or after the thirty-first day of December then last, or otherwise to the said day of December inclusive; and
- (d) Shall state whether the audit has been conducted by a public auditor appointed as by this Act is provided, and by whom, and if by any persons other than a public auditor, shall state the name, address, and calling or profession of every such person, and the manner in which, and the authority under which, he is appointed.

The society shall, together with the annual return, send a copy of the report of the auditors, or if more than one such report has been made during the period included in the return, a copy of each of such reports.

Supply of copies of annual returns.

15.—Every registered society shall supply gratuitously to every member or person interested in the funds of the society, on his application, a copy of the last annual return of the society for the time being.

Copy of last Balance Sheet.

16.—Every registered society shall keep a copy of the last Balance Sheet for the time being, together with the report of the auditors, always hung up in a conspicuous place at the registered office of the society.

Inspection of books.

By members.

17.—(1) Save as provided by this Act, no member or person shall have any right to inspect the books of a registered society, notwithstanding anything in the existing rules relating to such inspection.

(2) Any member or person having an interest in the funds of a registered society shall be allowed to inspect his own account and the books containing the names of the members at all reasonable hours at the registered office of the society, or at any place where the same are kept, subject to such regulations as to the time and manner of such inspection as may be made from time to time by the general meetings of the society.

(3) A registered society may, by any rules registered after this Act is passed, authorise the inspection of any of its books therein mentioned, in addition to the said books containing the names of members, under such conditions as are thereby imposed, so that no person, unless he

be an officer of the society, or be specially authorised by a resolution thereof, shall have the right to inspect the loan or deposit account of any other member without his written consent.

By order of registrar.

18.—(1) The registrar may, if he thinks fit, on the application of ten members of a registered society, each of whom has been a member of the society for not less than twelve months immediately preceding the date of the application, appoint an accountant or actuary to inspect the books of the society, and to report thereon.

(2) Provided as follows:—

(a) the applicants shall deposit with the registrar such sum as a security for the costs of the proposed inspection as the registrar may require; and

(b) all expenses of and incidental to any such inspection shall be defrayed by the applicants, or out of the funds of the society, or by the members or officers, or former members or officers of the society in such proportions as the registrar may direct.

(3) A person appointed under this section shall have power to make copies of any books of the society, and to take extracts therefrom, at all reasonable hours, at the registered office of the society, or at any place where the books are kept.

(4) The registrar shall communicate the results of any such inspection to the applicants and to the society.

Dissolution of societies.

58.—A registered society may be dissolved—

(a) By an order to wind up the society, or a resolution for the winding up thereof, made as is directed in regard to companies by the Companies Acts 1862 to 1890, the provisions whereof shall apply to any such order or resolution, except that the term “registrar” shall for the purpose of such winding-up have the meaning given to it by this Act; or

(b) By the consent of three-fourths of the members testified by their signatures to an instrument of dissolution.

59.—Any proceedings in the winding-up of a registered society which at the passing of this Act are pending in any County Court may, on application made by or on behalf of the registrar, with the consent of the Treasury, be transferred to the High Court, and thereupon the Companies (Winding-up) Act 1890 shall, so far as applicable, apply thereto accordingly.

60.—Where a registered society is wound up in pursuance of an order or resolution the liability of a present or past member of the society to contribute for payment of the debts and liabilities of the society, the expenses of winding-up, and the adjustment of the rights of contributories amongst themselves, shall be qualified as follows :—

- (a) No individual, society, or company, who or which has ceased to be a member for one year or upwards prior to the commencement of the winding-up, shall be liable to contribute ;
- (b) No individual, society, or company, shall be liable to contribute in respect of any debt or liability contracted after he or it ceased to be a member ;
- (c) No individual, society, or company, not a member, shall be liable to contribute, unless it appears to the Court that the contributions of the existing members are insufficient to satisfy the just demands on the society ;
- (d) No contribution shall be required from any individual, society, or company exceeding the amount, if any, unpaid on the shares in respect of which he or it is liable as a past or present member ;
- (e) An individual, society, or company shall be taken to have ceased to be a member, in respect of any withdrawable share withdrawn, from the date of the notice or application for withdrawal.

61.—Where a society is terminated by an instrument of dissolution :—

- (a) The instrument of dissolution shall set forth the liabilities and assets of the society in detail, the number of members and the nature of their interests in the society respectively, the claims of creditors (if any) and the provisions to be made for their payment, and the intended appropriation or division of the funds and property of the society, unless the same be stated in the instrument of dissolution to be left to the award of the chief registrar ;
- (b) Alterations in the instrument of dissolution may be made with the like consents as hereinbefore provided, and testified in the same manner ;
- (c) A statutory declaration shall be made by three members and the secretary of the society that the provisions of this Act have been complied with, and shall be sent to the registrar with the instrument of dissolution ; and any person knowingly making a false or fraudulent declaration in the matter shall be guilty of a misdemeanour ;

- (d) The instrument of dissolution and all alterations therein shall be registered in the manner herein provided for the registry of rules, and shall be binding upon all the members of the society ;
- (e) The registrar shall cause a notice of the dissolution to be advertised at the expense of the society in the *Gazette* and in some newspaper circulating in or about the locality in which the registered office of the society is situated ; and unless, within three months from the date of the *Gazette* in which such advertisement appears, a member or other person interested in or having any claim on the funds of the society commences proceedings to set aside the dissolution of the society in the County Court of the district where the registered office of the society is situate, and such dissolution is set aside accordingly, the society shall be legally dissolved from the date of such advertisement, and the requisite consents to the instrument of dissolution shall be considered to have been duly obtained without proof of the signatures thereto.
- (f) Notice shall be sent to the central office of any proceeding to set aside the dissolution of a society, not less than seven days before it is commenced, by the person by whom it is taken, or of any order setting it aside, within seven days after it is made, by the society.

Public auditors.

72.—The Treasury may appoint public auditors for the purposes of this Act, and may determine the rates of remuneration to be paid by registered societies for the services of such auditors, but the employment of such auditors shall not be compulsory.

SCHEDULES.

SCHEDULE I.

Enactments repealed.

Session & Chapter	Short Title	Extent of Repeal
39 & 40 Vict. c. 45	The Industrial and Provident Societies Act 1876	The whole Act
43 Vict. c. 14	The Customs and Inland Revenue Act 1880	Section 8
46 & 47 Vict. c. 47	The Provident Nominations and Small Intestacies Act 1883	So much as relates to industrial and provident societies

SCHEDULE III.

FORM OF STATEMENT TO BE MADE OUT BY A SOCIETY CARRYING ON
THE BUSINESS OF BANKING.

1.—Capital of the society :—

- (a) Nominal amount of each share ;
- (b) Number of shares issued ;
- (c) Amount paid up on shares.

2.—Liabilities of the society on the first day of January (or July)
last previous :—

- (a) On judgments ;
- (b) On specialty ;
- (c) On notes or bills ;
- (d) On simple contract ;
- (e) On estimated liabilities.

3.—Assets of the society on the same date :—

- (a) Government or other securities (stating them) ;
- (b) Bills of exchange and promissory notes ;
- (c) Cash at the bankers ;
- (d) Other securities.

PUBLIC AUDITORS.

Official rates of Payment :

For auditing the Accounts of Friendly Societies and specially authorised Societies granting Friendly Society benefits, the scale of payments shall be :—

	£	s	d
For Societies consisting of not more than 100 members ...	1	1	0
For Societies with over 100 members but not exceeding 500 members, in respect of each 100 members or part thereof	1	1	0
For Societies consisting of over 500 members, in respect of the first 500 members	5	5	0

With an additional 10s. 6d. in respect of each additional 100 members or part thereof, no fee, however, to exceed £52 10s., unless by special arrangement.

For auditing the Accounts of all other Societies registered under the Friendly Societies Acts, viz., Cattle Insurance Societies, Benevolent Societies, Working Men's Clubs, specially authorised Societies (except such as grant Friendly Society benefits), the scale of payment shall be :—

	£	s	d
For Societies whose total gross receipts do not exceed £2,000 per annum	1	1	0
For Societies whose total gross receipts exceed £2,000 but do not exceed £10,000 per annum, in respect of each £2,000 or fraction thereof	1	1	0
Where the gross receipts exceed £10,000 per annum, the fee to be fixed by private arrangement.			

For auditing the Accounts of Industrial and Provident Societies the scale of payment shall be :—

	£	s	d
For Societies whose total sales do not exceed £2,000 per annum	1	1	0
For Societies whose total sales exceed £2,000 but do not exceed £10,000 per annum, in respect of each £2,000, or fraction thereof	1	1	0
For Societies whose total sales exceed £10,000, but do not exceed £25,000 per annum, in respect of the first £10,000	5	5	0
With an additional 10s. 6d. in respect of each additional £2,000, or fraction thereof.			

Where the sales exceed £25,000 per annum, the fee to be fixed by special arrangement.

The word "sales" in the case of societies for the buying and selling of land, to include instalments in repayment of advances.

The scales of fees apply only in cases where the society is located within the district assigned to the auditor employed. If a society employs an auditor appointed for any other district, special terms may be arranged. The auditor may accept audits on terms lower than those of the above scale.

PUBLIC VALUERS.

When the benefits to be valued do not exceed two classes of sick allowance and deferred annuities, together with sums payable on the death of members and of their wives, the scales of payment to public valuers are as follows :—

Societies of not more than 75 members	...	£3	3	0
„ over 75 and not exceeding 100	...	4	4	0
„ 100 „ „ 150	...	5	5	0
„ 150 „ „ 200	...	6	6	0
„ 200 „ „ 300	...	7	7	0
„ 300 „ „ 400	...	8	8	0
„ 400 „ „ 500	...	9	9	0
„ 500 „ „ 600	...	10	10	0
„ 600 „ „ 750	...	12	12	0
„ 750 „ „ 1000	...	15	15	0

With a further £5 5s. for every 500 members or portion thereof beyond the total number of members not exceeding 2,500. Beyond 2,500 members the fee to be the matter of special arrangement, as well as in all cases where the number of benefits exceed that above mentioned. Valuers may accept valuation on terms lower than those of the above scale. Valuers must take such steps as they think fit for obtaining payment of their fees.

Note.—Employment of a Public Valuer under the Friendly Societies Act is not compulsory on any society.

APPENDIX B.

REPORTS OF CASES, THE DECISIONS OF WHICH ARE OF PROFESSIONAL INTEREST.

The case of THE OXFORD BUILDING SOCIETY.

(Decided before Mr. Justice KAY in the Chancery Division, on 8th
November 1886.)

*Company—Director—Liability—Payment of Dividend out of Capital—
“Realised profits”—Companies Act 1862, s. 165.*

One of the articles of association of a company was as follows: “No dividends shall be payable except out of the realised profits arising from the business of the company.” The business of the company consisted in lending money to builders on mortgage, generally at $8\frac{1}{2}$ per cent., repayable by instalments of principal and interest in fourteen years. In their Balance Sheets the company took credit “for the present value of the repayments on mortgages held by the company,” which amount was treated as profits immediately available for payment of dividend. The basis of the estimate by which the amount of the present value was arrived at was an assumption that every one of the securities on which the company were advancing money was ample to provide for principal, interest, and costs. For this the directors had nothing but the assurance of their surveyor, who was also secretary. In the winding-up of the company a summons was taken out by a creditor to obtain repayment from the directors of the sums paid by them from the commencement of the company by way of dividend in excess of the realised profits arising from the company’s business.

Graham Hastings, Q.C., Ashton Cross, and Hamilton for the applicant.

Sir H. Davey, Q.C., Maclean, Q.C., and Buckley, for the directors, contended that, even if it were the fact that from the commencement of the company the directors had continually paid dividends out of capital, yet they could not be made liable unless their conduct amounted to fraud. They further contended that the word "realised" meant no more than "real profits honestly earned," and that the use of that word did not impose on the directors any further liability than that which was imposed upon them by the general law.

Creed for the liquidator.

JUDGMENT.

Kay, J., held that the directors were liable. It was not necessary to prove fraud. It was settled by authority (1) that directors were *quasi-trustees* of the company; (2) that directors who improperly paid dividends out of capital were liable to repay such dividends personally upon the company being wound up; (3) that this liability might be enforced by a creditor, or by the liquidator under section 165 of the Companies Act 1862, or by the incorporated company before a winding up; (4) that the acquiescence of shareholders did not affect the creditors in such a case; and (5) that such an act was a breach of trust, and the remedy was not barred by the Statute of Limitations. The word "realised" must have its ordinary commercial meaning, which, if not equivalent to "reduced to actual cash in hand," must at least be rendered tangible for the purpose of division." The meaning of the word was the direct converse of the word "estimated." The directors had paid dividends out of capital on the chance that profits might be realised sufficient to justify such payments, which was precisely what the articles expressly forbade. It was improper to pay any dividend in respect of an instalment not actually paid, because until payment no part of that instalment could be treated as a realised profit. It would be the duty of the directors, if each instalment were punctually paid, to treat a sufficient part of each instalment as the interest on the advance, or the unpaid portion of the advance, to that time. This amount, after providing for all current expenses and outgoings, and setting apart a sufficient sum to meet contingencies, would be properly applicable to pay a dividend. Upon this footing his Lordship declared that the directors were jointly and severally liable for the amounts improperly paid away in each year of their directorship, amounting in the aggregate to £44,433 4s. 6d., and, as the liability was founded upon a breach of trust, they must also pay interest at 4 per cent.

(L.J. Notes 1886, p. 135.)

The case of THE LEEDS ESTATE BUILDING AND INVESTMENT
SOCIETY, LIM. *v.* SHEPHERD.

(Decided before Mr. Justice STIRLING, in the Chancery Division, on
9th August 1887.)

*Company—Directors—Misfeasance—Payment of Dividends out of Capital—
False Balance Sheets—Auditor's Liability.*

In 1869 the plaintiff company was formed and registered under the Act of 1862 for the purpose of dealing in lands and lending money on mortgage. In 1882 it went into voluntary liquidation.

By article 63 it was provided that when the company paid a dividend of 5 per cent. the directors were to receive 10s. for every meeting attended by them, and the remuneration was to be increased by 2s. 6d. for every additional 1 per cent. of dividend.

By articles 79 and 80 the directors were authorised to declare a dividend upon such estimate of profits as they might think proper to recommend, but no dividend was to be payable except out of profits.

Articles 86 to 89 provided that the directors should cause true accounts to be kept, and should lay before the company once in every year a statement of the income and expenditure, and also a Balance Sheet in the form prescribed by Table A of the Companies Act 1862.

Articles 90 to 101 related to the auditing of the accounts, and provided that the auditors should state in their report whether, in their opinion, the Balance Sheet was a full and fair Balance Sheet, properly drawn up so as to exhibit a true and correct view of the state of the company's affairs.

The articles also provided for the appointment of a manager and secretary, whose remuneration was to be fixed by the directors.

Except in 1876 the company made no profits during the whole period during which it carried on business.

This action was brought by the company in liquidation against the directors, the manager, and the auditor of the company to make them liable in respect of certain sums paid out of capital for dividends, and for fees and bonuses to the directors and manager respectively.

The Balance Sheets were false and misleading and contained fictitious items, and were framed with a view to the declaration of dividend. They were prepared by the manager and examined by the auditor. In examining the Balance Sheets the auditor was not furnished with a copy of the articles, and he did not comply with their provisions. The directors did not investigate the accounts, but trusted entirely to the manager and the auditor; and they did not know that the

company had been paying dividends out of capital, or that the Balance Sheets were inaccurate. The Balance Sheets were not shown to the shareholders as required by the articles.

JUDGMENT.

Stirling, J., held, following *In re The Oxford Benefit Building and Investment Society*, 56 L.J. Rep. Ch. 98, that the directors were bound to make good the several sums paid out of capital, and that the manager and auditor were liable for damages to the like amount. With reference to the case against the auditor, his Lordship said that it was the duty of the auditor not to confine himself merely to the task of ascertaining the arithmetical accuracy of the Balance Sheet, but to see that it was a true and accurate representation of the company's affairs. It was no excuse that the auditor had not seen the articles when he knew of their existence. The Statute of Limitations had been pleaded on his behalf, and the plea had not been resisted, so that his liability would be limited to the dividends paid within six years of the commencement of the action.

(L.J. Notes 1887, p. 130.)

The (appeal in the) case of LEE *v.* NEUCHATEL ASPHALTE
COMPANY, LIM.

(Decided before COTTON, LINDLEY, and LOPES, L.JJ., in the Court of Appeal, on 9th February 1889.)

*Companies Act 1862—Table A—Payment of Dividend out of Capital—
Meaning of "Capital"—"Profits"—As to obligation of Company to
provide for Depreciation of Wasting Property before declaring Dividends.*

The Court of Appeal delivered judgment in this important company case, which was argued before them on the 4th, 5th, and 6th inst., on an appeal by the plaintiff in the action from the decision of Mr. Justice Stirling. The action was brought by Mr. Charles John Lee, on behalf of himself and all of the ordinary shareholders of the Neuchatel Asphalte Company, against that company and the directors, one of whom, Mr. J. Varley, had been appointed to represent the preference shareholders of the company. The object of the action was to restrain the payment of a dividend of 9s. per share, proposed to be paid out of what were alleged by the defendants to be the profits of the company for the year ending December 31 1885. The company was on July 9 1873 incorporated under the Companies Act of 1862, with a capital of £1,150,000, divided into 35,000 preferred shares, and 80,000 ordinary shares, of £10 each respectively. One of the objects of the company, as defined by

the memorandum of association, was to acquire, as from July 1 1873, and on the terms expressed in an agreement dated July 17 1873, a concession granted by the Government of the Canton of Neuchatel, in Switzerland, and held by the Neuchatel Rock Paving Company, and the exclusive right thereunder of getting the bituminous rock and mineral products from the Val de Travers, and also all the mines, works, business, property, and assets of the last-mentioned company, and also all the concessions held by five other companies, and all the businesses, properties, and assets of these various companies. The company had also power to work and get bituminous rock, according to any concession granted to the companies, and the product of any mines acquired by the company, and to sell and dispose of the same, and to carry on the business of manufacturers of asphalte and bituminous rock pavement in every branch, and also to grant concessions and establish subsidiary companies. By the agreement of July 17 1873, the Neuchatel Company agreed to pay for the original concession and all the sub-concessions granted to the five subsidiary companies, and all the mines, properties and assets of the reconstituted original company and the five subsidiary companies in fully-paid preferred and ordinary shares in the Neuchatel Company. Thus the selling companies were to be paid not on a valuation in cash, but in shares, and the whole of the ordinary shares of the defendant company and 33,700 out of the 35,000 preferred shares were to be allotted to the selling companies in consideration of the transfer to the Neuchatel Company of their entire assets, including the concession granted by the Canton of Neuchatel. The agreement was duly carried into effect, and the concessions, properties and assets which were the subject-matter thereof were duly transferred to the Neuchatel Company, and the 80,000 ordinary shares and 33,700 preferred shares duly allotted and issued to the selling companies. With a nominal exception, no other shares in the Neuchatel Company had ever been issued. The articles of association of the company provided that no distribution of profits—except an interim dividend not exceeding 7 per cent. on the preferred and 4 per cent. on the ordinary shares—should be made without the consent of a general meeting, whose decision was to be final in case of any dispute as to the amount of net profits; and it was provided by article 100 that the directors might, before recommending any dividend, set aside and invest out of the net profits of the company such sum as they thought proper as a reserved fund to meet contingencies or equalise dividends, or repair or maintain the company's works, but should not be bound to reserve moneys for the renewal or replacing of any lease or of the company's interest in any property or concession. The concession referred to in the agreement and in the memorandum of association was for a period of 20 years commencing December 15 1867, and ending December 14 1887, and conferred on the *cessionnaire* the exclusive right of working

the asphalte mines within a certain defined area situate in the communes of Couvet and Travers, in the Canton of Neuchatel. The consideration for that concession originally consisted of a *minimum* annual rent of 40,000f. and a royalty of 19.75f. per ton of asphalte turned out ; but for the 11 years between December 16 1870 and December 16 1881, these terms were modified as follows—there was to be paid a *minimum* annual rent of 100,000f. and a royalty varying from 19.75f. to 5f. per ton. After December 16 1881 the parties were to return to the terms of the original concession. Soon after that concession had, with the consent of the Government of the Canton, been transferred to the Neuchatel Company, it appeared from the annual reports of that company that the terms of it began to be felt unduly burdensome to the company, and negotiations were entered into for the modification and extension of it, and ultimately these were effected by a convention agreed on in November 1877, and finally adopted on January 22 1878. The more material modifications thus introduced were these—(1) The duration of the concession was extended for twenty years, so that, instead of expiring on December 14 1887, it would not expire until December 14 1907 ; (2) the area under which the mines could be worked was very considerably enlarged ; (3) the consideration for the modified concession consisted of (a) a present payment in cash of 200,000f. (£8,000), (b) a royalty of 6f. per ton of asphalte taken out of the mine, subject to a proviso that (c) if the annual working at the price of 6f. per ton should not produce 150,000f., the *cessionnaires* should nevertheless pay that amount by way of *minimum* royalty or dead rent. The result of the modification of the royalty as applied to the actual working of the company between the beginning of 1878 and the end of December 1885 was that the Government of Neuchatel had received about £39,000 less than would have come to it had the terms of the concession remained as they stood in 1873. The company had worked the mines and carried on business from its formation down to the present time. For the year ending December 31 1879 the accounts showed an excess of receipts over expenditure to the amount of £8,165 12s. 1d., and in respect of this year's working a dividend amounting to 2s. 6d. per share, and making £4,252 10s. was, for the first time, declared. All the subsequent accounts showed a like excess of receipts over expenditure to a considerable extent. Dividends were declared for the years 1881, 1882, and 1883 of 5s., 3s. 6d., and 5s. per share. In 1884 no dividend was declared, although the accounts showed a balance of £39,359 to the balance of the Profit and Loss Account on December 31 1884 ; and this large sum was dealt with as follows—£1,000 was written off in respect of the sum paid for the modification and extension of the concession in 1877, and the balance of £38,359 was written off the cost in shares of the original concession and other assets taken over by the company on its formation. It appeared from the report for 1884 that the directors had resolved that the

sum paid for the renewal of the concession should be written off at the rate of £1,000 a year. The accounts for the year 1885 showed an excess of receipts over expenditure to the amount of £17,140 13s. 2d., out of which, after setting aside a sum of £1,000 in reduction of the sum paid in 1887 for the renewal of the concession, it was recommended by the directors and resolved by a majority of the shareholders that a dividend on the preferred shares at the rate of 9s. a share should be paid. Mr. Justice Stirling, before whom the action was tried, dismissed the action, and the plaintiff now appealed.

JUDGMENT.

The Court dismissed the appeal.

Lord Justice Cotton, in giving judgment, after stating the nature and objects of the respondent company, and referring to the fact that the assets of the respondent company consisted of the concession and the other subsidiary rights taken over from the previously existing companies, and that these assets had not been paid for in cash, said:— Three points had been raised on behalf of the appellant. First, it was said that a principal part of the capital of the company had been lost. If by that it was meant that any part of the assets had been lost, in my opinion that is not correct, for the evidence shows that the assets of the company at present are of larger amount; its nominal capital, or, as I should prefer to call it, its share capital, is improved in value now to what it was when the company was formed in 1873, additional time for the concession to run having been obtained and less royalty having to be paid. Secondly, it was said that the property of the company was not sufficient to make good its nominal or share capital, and that the deficiency should be made up before any dividend ought to be paid. In my opinion, that argument is entirely wrong and involves a misapplication of the term “capital.” “Capital” is used in many senses, but the share capital of a company means the amount of its nominal capital divided into so many shares. The Companies Acts do not require, and it would be impossible that the assets of a company should be stated in its memorandum of association, though its share capital must be. No alteration can be made in the share capital of a company except in the manner provided for by the Companies Acts, and the share capital must not be applied except for some of the purposes for which the company was formed. But, in my opinion, there is no obligation on the company to make up the assets of the company so as to meet its share capital where the share capital has been issued under a duly registered contract, enabling allotment for something different from cash. Of course, if the contract was fraudulent or illusory, it might well be that the shareholders would be bound to pay up, in cash, the difference; but there is no suggestion of anything of that kind here. The payment of the proposed dividend, therefore, is not a return of

capital ; it is not a return of money which the shareholders were bound to provide in order to make up the nominal amount of their shares. The third point raised was one of more difficulty : it was said that this concession being a wasting property, the payment of this dividend was dividing part of the capital of the company represented by this concession. It is a well-established principle of company law that the capital assets of a company must not be applied for any purpose not one of the objects of the company, and though there is nothing in the Company Acts which says that dividends are not to be paid except out of profits—for the article to that effect in Table A in the schedule to the Act of 1862 is merely a matter of internal regulation—yet it is well established that the paying of a dividend is not one of the objects of a company, and therefore that the capital assets of a company must not be applied in that way. If the directors were to sell what was a permanent property of the company and then to declare a dividend, that would come within the principle laid down in *Guinness v. Land Corporation of Ireland* (L.R. 22 Ch.D. 349)—that the capital of a company cannot be applied for purposes not authorised. But that is not the case here, and we must take a reasonable and sensible view of the circumstances of this case. If it could be shown that this dividend was declared “for the purposes of fraud, or for any other improper motive, and that . . . the company has thereby in effect taken away from its creditors a portion of the capital which was available for their debts,” to use the words of Lord Justice Selwyn in *Stringer’s* case (L.R. 4 Ch. App., at p. 488), then this Court would interfere to prevent such improper dealing. But when the Court sees that the directors of the company have acted fairly and reasonably in ascertaining whether this is in reality a part of the capital assets or not, then the Court is very unwilling to interfere with the discretion exercised by directors who have the management and regulation of the affairs of the company. In my opinion, it was not necessary, as Mr. Rigby suggested, that the directors should set apart each year a sum to answer the supposed annual diminution of this property by reason of its wasting nature. The Lord Justice then referred in detail to the cases of *Davison v. Gillies* (L.R. 14 Ch.D. 347n.) and *Dent v. London Tramways Company* (L.R. 16, Ch.D. 344), which, he said, were consistent both with each other and with the view which he took in the present case, and said that, having regard to the nature and constitution of this mercantile company, he was not satisfied that a proper provision had not been made for depreciation by the establishment of a Reserve Fund, and considered that it would be wrong for the Court to interfere to prevent the payment of the proposed dividend.

Lord Justice Lindley agreed. His Lordship said the actual point to be decided is an easy one, but the difficulty arises from the fact that the Court is urged to lay down general principles of law, which, if adopted, would paralyse the whole trade of the country. The respon-

dent company was formed for the purpose of working certain asphalt mines of which it had got a lease. It was quite obvious that with respect to such a property every ton of stuff got out of that which was bought with capital represented a portion of capital. It was said that a division of the profit arising from the sale of such was a return of capital. If that was so, it is not, at all events, such a return of capital as is prohibited by the Company Acts. There is nothing in any of the Company Acts prohibiting anything of the kind. The only provisions in those Acts relating to capital were sections 8, 12, 26, 28, and 34 in the Act of 1862; sections 9-20 in the Act of 1867; and sections 3-5 in the amending Act of 1877. There was nothing in any of those sections as to the mode of payment of profits or dividends. It has been very judiciously and properly left to the commercial world to settle how the accounts were to be kept. The Acts do not say what expenses are to be charged to Capital Account and what to Revenue Account. Such matters were left to the shareholders; they may or may not have a sinking fund or a deterioration fund, the articles of association may or may not contain regulations on these matters; if they do the regulations must be observed, if they do not the shareholders can do as they like so long as they do not misapply their capital. In this case one of the articles provides that the directors shall not be bound to reserve moneys for the renewal or replacing of any lease or of the company's interest in any property or concession. Mr. Rigby says that that provision in the articles is contrary to law. Now, the Companies Act 1862 does not require the capital to be made up if lost, and it does not prohibit payment of dividends so long as the assets are of less value than the capital called up, nor does it make loss of capital a ground for winding-up. The argument seems to be founded on the notion that the company is somehow a debtor to its capital; that may be a convenient notion from an accountant's point of view, but has nothing to do with law. Though the Acts do not say so, there are general principles of law which prohibit the capital of a company being applied for purposes other than those mentioned in the memorandum of association, and, further, if any of the purposes mentioned in the memorandum of association are expressly or impliedly forbidden by the statutes, then the capital of the company cannot be applied for those purposes (see *Trevor v. Whitworth*, 12 App. Cas. 409). But if a company is formed to acquire or work property of a wasting nature, *e.g.*, a mine, quarry, or patent, the capital expended in acquiring the property may be regarded as sunk and gone, and if the company retains assets sufficient to pay its debts, any excess of money obtained by working the property over the cost of working it may be divided among the shareholders; and this is true, although some portion of the property itself is sold, and in one sense the capital is thereby diminished. If it is said that such a course involves payment of dividends out of capital, the answer is that the Acts

nowhere prohibit such a payment as is here supposed. The proposition that it is *ultra vires* to pay dividends out of capital is very apt to mislead, and must not be understood in such a way as to prohibit honest tradings. It is not true, as an abstract proposition, that no dividends can be properly declared out of moneys arising from the sale of property bought by capital. But it is true that if the working expenses exceed the current gains, profits cannot be divided, and that if in such a case capital is divided and paid away as dividend, the capital is misapplied, and the directors implicated in the misapplication may be compelled to make good the amount misapplied. This was the case in *Rance's case* (L.R. 6 Ch. App. 104); in the *Oxford Benefit Building Society's case* (L.R. 35 Ch.D. 502); in *Leeds, &c., Investment Company v. Shepherd* (L.R. 36 Ch.D. 787); and in *Stringer's case* (L.R. 4 Ch. App. 475). In the present case the articles say that there need be no sinking fund; consequently, capital lost need not be replaced; nor, having regard to these articles, need any loss of capital by removal of bituminous earth appear in the Profit and Loss Account of the working of the company's property. Our decision, therefore, in this case is quite consistent with the two cases before the late Master of the Rolls of *Davison v. Gillies* and *Dent v. London Tramways Company*.

Lord Justice Lopes: Very important questions are raised in this case. It is said by the appellants that a company is not to be at liberty to pay a dividend unless they can show that their available property at the time of declaring the dividend is equivalent to their nominal or share capital. In my opinion, such a contention is untenable. The nominal or share capital is diminished in value, not by means of any improper dealing with it by the company, but by reason of causes over which the company has no control or by reason of its inherent nature. That diminution need not, in my opinion, be made good out of revenue. In such a case a dividend may be paid out of current annual profits—out of profits arising from the excess of ordinary receipts over expenses properly chargeable to the Revenue Account, provided there is nothing contrary to the articles of association prohibiting such an application, and provided it is done honestly. If the contrary views were adopted, it might be successfully contended that where, owing to extraneous circumstances, the capital is increased in value, that increase might be dealt with as revenue profits and go to increase the dividend. That is contrary to all practice and to principle. It is said that where the capital is of a wasting character a sum must be laid aside to meet the depreciation, and that until such sum is laid aside there is nothing in the nature of profit divisible among the shareholders. The Lord Justice referred to the article providing that the directors should not be bound to reserve moneys for the renewal or replacing of any lease or of the company's interest in any property or concession, and proceeded:—Unless this article is *ultra vires* no question arises. Is

the article *ultra vires*? I know of no obligation imposed by law or statute to create a Reserve Fund out of revenue to recoup the wasting nature of capital. Subject to any provision to the contrary contained in the articles, I believe the disposition of the revenue is entirely in the hands and under the control of the company. Provided there is by the company no infraction of the capital and nothing in the articles to the contrary, the disposition of the revenue is a matter of internal arrangement. I am unable to see in this case that either capital or the produce of capital has been dealt with in a way which is not authorised.

The case of BOLTON *v.* NATAL LAND AND COLONIZATION
COMPANY, LIM.

(Decided before Mr. Justice ROMER, in the Chancery Division,
on 8th, 9th, and 10th December 1891.)

*Company—Losses of Capital not made good—Subsequent Declaration of
Dividend out of working Profits made since Losses sustained—Injunction.*

The fact that some portion of the capital of an incorporated company limited by shares has been lost, and not made good, affords no ground for restraining the payment of a dividend out of profits subsequently earned. The business of an incorporated company, limited by shares in the ordinary way, consisted mainly in buying, holding, cultivating, letting, selling, and otherwise dealing with land in South Africa. In 1882 the company, under peculiar circumstances, debited their Profit and Loss Account for that year with the whole loss occasioned by writing off a certain debt of over £70,000 as a bad debt, and *per contra* credited the same Profit and Loss Account with a sum of nearly £70,000 in respect of an increase in value attributed (rightly or wrongly) to their lands (or a portion of them) in South Africa, above and beyond the cost price at which such lands previously stood in the books of the company, the result being to make the Profit and Loss practically balance each other upon the year's accounts. The company, having subsequently earned a working profit, declared a dividend thereout, in respect of the year 1885. Thereupon the plaintiff, in an action commenced in 1886 to restrain the payment of such dividend, contended that, at the time the value of the lands was written up in 1882, they were valued, and now stood in the company's books at an amount considerably exceeding their true value, and that, before a profit could be deemed to have been made which would be properly available for the payment of a dividend, the lands in question must be written down to their true value, and the difference debited to the Profit and Loss Account, in the same way as the supposed increase had been credited to the Profit and Loss Account for the year 1882.

JUDGMENT.

Held, that, assuming that a part of the capital had in fact been lost, and not subsequently made good, no sufficient ground was thereby afforded for restraining the payment of the dividend; that the fact of the company having written up the value of their land in 1882, and credited the increase to the profit of that year in the manner described, did not place them under any obligation to bring into account in every subsequent year the increase or decrease in the value of their lands; and that, having regard to the case of *Lee v. The Neuchatel Asphalt Company* (61 L.T. Rep. N.S. 11; 41 Ch.D. 1), it was not correct, in estimating the profits of a year, to take into account the increase or decrease in the value of the capital assets of the company.

The case of OURO PRETI GOLD MINES OF BRAZIL.

(Decided before Mr. Justice CHITTY, in the Chancery Division,
on 29th October 1892.)

Practice—Company—Reduction of Capital—Evidence of Loss.

This was a petition for reduction of capital. The chairman deposed that £80,000 was lost, but gave no explanation under what circumstances such loss took place.

JUDGMENT.

Chitty, J., ordered the petition to stand over for further evidence. In practice he often had the Balance Sheet produced to see that no dividends had been paid out of capital. Some detailed evidence, showing clearly in what manner the £80,000 loss took place, must be given.

The case of the NEW ORIENTAL BANK CORPORATION, LIM.

(Decided before Mr. Justice VAUGHAN WILLIAMS, in the Chancery Division, on 17th December 1892.)

Judicial views as to the duties of an Auditor—Voluntary Winding-up under Supervision v. Compulsory Order.

In this case an order was made before the Long Vacation continuing the voluntary winding-up of the bank under the supervision of the Court. Mr. Edward Pratt, a creditor of the company, afterwards presented a petition asking for a compulsory winding-up order, and this petition was ordered to stand over in order that an affidavit might be made by Mr. Thomas A. Welton, the voluntary liquidator. Affidavit having now been made by Mr. Welton, Mr. Pratt's petition was again brought on for hearing.

Mr. Justice Vaughan Williams said he had read Mr. Welton's affidavit and the exhibits thereto, and had been much impressed with one part, which stated Mr. Welton's reasons for saying that a compulsory winding-up order, if now made, would cause great additional expense. It was desirable, if possible, to avoid that. On the other hand, the affidavit had not removed the impression that there were certain matters which required looking into more vigorously. His Lordship thought that Mr. Welton, having been auditor, was not perhaps the best person to conduct such inquiries. It was desirable to continue the liquidation under supervision, provided proper steps could be taken to have these matters carefully gone into.

Sir Horace Davey, Q.C. (who, with Mr. Robinson, Q.C., and Mr. Ingle Joyce, represented the voluntary liquidator and the company), suggested that Mr. Pratt should join the committee of creditors supervising Mr. Welton. In supervision proceedings, if the liquidator did not give satisfaction, any creditor could come to the Court on his own account.

Mr. Justice Vaughan Williams said the real difficulty was that the creditors had not full information. One of the advantages attending a compulsory order was that if necessary there could be a public examination of directors, &c.

Sir Horace Davey said no doubt the powers under such an order were very large, but he had never heard complaints that liquidators and their advisers were not active enough. It was often said they were too ready to take proceedings.

Mr. Justice Vaughan Williams said that might be so generally, but here the liquidator had been auditor.

Sir Horace Davey said that Mr. Welton's position as liquidator of the old bank and as auditor of the new one, and the experience he had thus gained, made it advantageous to the creditors to have him for a liquidator. He was extremely anxious that all the assets should be realised, and he was bound to consider the wishes of the creditors who were against the additional expense and delay of a compulsory winding-up. Of course, opinions differed as to whether compulsory proceedings were more expensive than those under supervision, and they would probably continue to differ, as this was a free country. No grounds whatever were shown for saying that Mr. Pratt was "prejudiced" by the proceedings within the meaning of section 145 of the Companies Act 1862. An allegation had been made that some of the directors had introduced as customers of the bank certain companies of which they were themselves directors, and that the bank had lent money to these companies; but it did not follow that any personal liability attached to such directors or that what they had done was improper. Nor did

it follow that the directors were personally liable because through a mistaken but *bond fide* view as to the amount of income a dividend had been paid which such income was insufficient to meet. Nor was there any ground of complaint against Mr. Welton as auditor. He had only to see that the Balance Sheets accorded with the books, and could not inquire into all the circumstances which induced the directors to value debts or other assets at a certain amount. The liquidator invited full inquiry. He placed himself in the hands of the Court, and if any means could be pointed out by which the assets could be more efficiently collected he would, of course, employ them.

Mr. George Lawrence, Mr. Theobald, and Mr. F. E. Lemon also opposed the petition.

Mr. Pratt, the petitioner, appeared in person. He said he was not willing to join the committee, as it would not meet the requirements of the case. Moreover, he was too old for the duties which it would entail, especially as he would probably meet with some hostility. He read a long written statement in support of his petition, urging that full inquiry was necessary, and that such inquiry could only be satisfactorily had in compulsory winding-up proceedings.

JUDGMENT.

Mr. Justice Vaughan Williams said that he should not make the order asked for, and must dismiss the petition. His Lordship regretted that Mr. Pratt did not accept the position which had been offered to him on the committee of creditors. At the same time, he thought the petition had not been unreasonably presented. The result of it was that the attention of the Court had been called to matters which might require further examination and investigation. As to Mr. Welton's affidavit, his Lordship was not going to pass judgment on him. Mr. Pratt had not made any tangible suggestion of misconduct against Mr. Welton, though he had suggested that, as auditor, he might have prevented a certain dividend from being declared. His Lordship did not agree with certain views which he gathered from Mr. Welton's affidavit that Mr. Welton entertained as to the duties of an auditor. His Lordship did not think it was taking the true view of the duties of an auditor to arrive, from conversations with directors, at a conclusion whether a Balance Sheet fairly represented the state of the bank's affairs. It was not for an auditor to consider the *bona fides* of directors, but to deal with the books of the company and with commercial details and figures—not to consider the honesty of its officers. If an auditor once embarked on such an inquiry he was apt, when he arrived at a conclusion, not to continue his investigations. His Lordship, however, was not saying that the auditor could, when he looked into the books, have formed an opinion that the statements in the Balance Sheet were

unfounded—there might be nothing on the face of the books to lead an auditor to doubt such statements—and he accepted Mr. Welton's statement that he was anxious to assist in full investigation. The petition would be dismissed without costs, and the costs of the liquidator would be costs in the winding-up.

The case of THE EDINBURGH UNITED BREWERIES, LIM.,
AND OTHERS *v.* JAMES A. MOLLESON (NICHOLSON'S
TRUSTEE) AND ANOTHER.

(Decided in the Scottish Court of Appeal before the LORD PRESIDENT,
and Lords ADAM, M'LAREN, and KINNEAR, on 17th March 1893.)

Investigations preparatory to the formation of Limited Companies.

In this action the Edinburgh United Breweries, Lim., and William H. Dunn, 27 Bishopsgate Street, London, sued James A. Molleson, C.A., Edinburgh, as trustee of David Nicholson, Parson's Green, for the reduction of the sale of the Palace Brewery, on the ground that the books had been falsified in order to show a larger profit than that actually earned during the two years preceding the sale. Lord Kyllachy assoilzied the defenders, with expenses, on the ground that if there was a fraud the pursuer had opportunity of discovering it by examination of the books. The pursuers reclaimed, and to-day the Court, following Lord M'Laren, adhered to the judgment of the Lord Ordinary, with expenses.

Lord M'Laren, who gave the judgment of the Court, said the case was peculiar in this respect, that while the action was laid on the ground of fraudulent representations, no personal fault was attributable to Mr. Molleson, who was known to be a gentleman of high standing in his profession. The case against him was that he employed Andrew Smith Geddes to keep the books of the brewery while it was under his management as trustee; that Geddes, for his own purposes, falsified the books and the Balance Sheets; that Mr. Dunn was induced to become the purchaser in reliance on the apparent profits exhibited on the face of the books and Balance Sheets, and was in that sense deceived by representations for which it was said Mr. Molleson was civilly responsible. So far as his Lordship understood, Geddes had no motive to falsify the books beyond the wish to please his employer and keep his situation by giving an aspect of fictitious prosperity to the business. By the agreement of November between Mr. Molleson and Mr. Dunn the sum of £3,700 was to be paid down, and the balance of the price was to be paid on 31st December, when the conveyance was granted. By the tenth clause of that agreement it was provided

that the arrangement proceeded upon the basis that the net profits from the brewery and wine businesses during each of the two years 1887 and 1888 amounted to £3,750, or thereabout, upon an average; and in the event of its being ascertained that that was not the fact, this arrangement should be at an end, and the second party (Mr. Molleson) should be bound to repay the sum of £3,700. The first party (Mr. Dunn), with the view of verifying the amount of the profits for the two years, should be entitled to have the books, accounts, and vouchers connected with the businesses examined by an accountant named by him. The question was whether Mr. Molleson, as vendor, was affected by the fact that false entries were made in the books by the clerk Geddes for the purpose of bringing out an apparent profit in excess of the real profit. The excess was stated at £1,250, but the exact sum was immaterial to the present inquiry. It was a condition of the bargain that the books had to be delivered to the purchaser for examination, and his Lordship thought that condition was not fulfilled by delivering dishonest books. It was just the same as giving no books at all; and his Lordship had come to the conclusion that Mr. Dunn was not barred by the 10th article from challenging the sale on the ground of fraudulent representations as to the profits of the business, because he only agreed to take the risk of profits on the condition that books containing a true record of the brewery transactions should be submitted to him for examination. But, while his Lordship held it to be established that a fraud was committed inducing Mr. Dunn to enter into the contract, it did not follow that the pursuers, severally or collectively, were in a position to enforce the claim of restitution. The really important question was whether Mr. Dunn had a right to reduce his contract of sale—such a right as he could communicate to the United Breweries, to whom he had sold the brewery for £28,500, the price he paid to Mr. Molleson being £20,500. Mr. Dunn resold the brewery at a profit, and he was not proposing to relinquish the profit of £8,000 which came to him indirectly through the false impression which the books produced on the minds of the purchasers from him. On the discovery of the fraud which had been practised upon him, Mr. Dunn was under no obligation to cancel the sale to the United Breweries. He had sold to them in good faith and without warranty. If Mr. Dunn proposed to repay the £8,000 on the ground that he could not conscientiously retain it, and to assign his claim of restitution against Mr. Molleson in order that the United Breweries might obtain redress, he would have found in him (Lord M'Laren) a convinced partisan of the duty of restitution. It would be no answer to him to say that he had the means of recouping himself by holding the United Breweries to their bargain. A purchaser in such a case was entitled to say—"I refuse to take a benefit which has been obtained by fraud: and I will neither hold my purchaser to his engagements nor will I submit to be bound by the deception which

has been practised on myself." His Lordship was not imputing any blame to Mr. Dunn, or to the parties whom he represented, because they had not begun by making restitution. He did not know that they had been asked to do so. He only wished to put their case in a clear light. He understood Mr. Dunn's position to be this—that he meant to keep the £8,000, which he was enabled to make by the exhibition of forged books and fraudulent Balance Sheets, and at the same time to try and cut down his title to the subject of sale on the ground that the title was vitiated by that very fraud. It was clear that, if Dunn were suing by himself alone, it would be a conclusive answer to his claim that he had sold the subjects at a price calculated on the erroneous value attributed to the subjects, that he had not repaid the price to his sub-vendor, and that he had, therefore, made a profit out of the fraud. The circumstance that he had bought back the property, and was thus enabled to offer restitution, would not, in his Lordship's judgment, improve his position. Plainly Dunn could communicate no higher right to the United Breweries than he himself possessed. The United Breweries had no direct claim of any kind either against Molleson or against Dunn. Whatever right of action they might acquire through Dunn, by being joined with him as pursuers, must be measured by his right, and it followed that the action, considered as an action at the instance of the United Breweries, must also fail.

Their Lordships concurred.

The case of **VERNER v. THE GENERAL AND COMMERCIAL INVESTMENT TRUST, LIM.**

(Decided before Mr. Justice STIRLING, in the Chancery Division,
on 6th March 1894.)

Trust Company—Obligation of Company to provide for Depreciation in Value of its Assets before paying Dividend—"Profits"—Dividends out of Capital—Trevor v. Whitworth considered—Lee v. Neuchatel considered—Provisions contained in Articles of Association.

This case raised a very important question in company law, viz., whether, where there has been a loss in the capital of a company through depreciation in the value of its assets, the company is entitled to pay dividends out of profits earned by means of its investments without first reducing its capital so as to meet such depreciation. The action was brought by William Henry Verner, on behalf of himself and all other stockholders of the defendant company other than the directors, against the company and the directors. It came before the Court upon a motion by the plaintiff asking that the defendants might be

restrained from declaring and distributing among the members of the company any dividend in respect of the financial year of the company terminating on February 28 1894. The company was incorporated on January 26 1888, under a memorandum and articles of association, with a capital of £600,000 in 60,000 shares of £10 each, all of which had been issued and fully paid up in cash, and converted into stock of two classes—preferred and deferred. In addition to its original share capital the company had borrowed £300,000 on the security of debenture stock bearing interest at 4 per cent., and secured by a floating charge upon all the assets of the company. There had thus come to the hands of the company £900,000, which had been invested in various securities authorised by the memorandum of association. The present market value of such investments was only £654,776, showing a depreciation of £240,000. According to the evidence of the plaintiff it appeared that “of such depreciation £75,000 or thereabouts represented the amount which there was no prospect of recovering within any reasonable period of time.” Consequently, in addition to a large depreciation, which might perhaps be temporary only, £75,000 must, as his Lordship pointed out in stating the facts of the case, be regarded as absolutely lost in respect of capital. The original investments had been changed from time to time. Some of these variations had resulted in losses, but upon others there had been substantial gains. The net result, however, of these changes of investment was that a profit of £27,000 had been realised and carried to the credit of a Reserve Fund. That had not been touched, and it was not proposed to be affected by anything which the directors were about to do. During the past year the receipts of the company in respect of income derived from their investments had exceeded the expenditure by upwards of £23,000. The question for the Court upon the motion was whether, there being a loss of capital to the amount of £75,000, and an excess of profits over expenditure of £23,000, a dividend could lawfully be declared and paid.

Mr. Graham Hastings, Q.C., and Mr. Kirby appeared for the plaintiff, and Mr. Buckley, Q.C., and Mr. Eve for the defendants.

JUDGMENT.

Stirling, J., in delivering his considered judgment, said (after stating the facts) that the action was a friendly one, but was one of great importance to the directors, because, if they made a mistake and wrongfully paid dividends out of capital, it would be a very serious thing for them in the event of the company subsequently going into liquidation. It was also very important from a legal point of view, because it was the first time that the Court had been asked to declare whether dividends could lawfully be declared under such circumstances. Up to a certain point the law upon the subject was clear. The

general proposition might be usefully stated from the judgment of the Lord Chancellor (Lord Herschell) in *Trevor v. Whitworth* (12 App. Cas., p. 415):—

“The Companies Act 1862 requires (section 8) that in the case of a company where the liability of the shareholders is limited the memorandum shall contain the amount of the capital with which the company proposes to be registered, divided into shares of a certain fixed amount, and provides (section 12) that such a company may increase its capital and divide it into shares of larger amount than the existing shares, or convert its paid-up shares into stock, but that, ‘save as aforesaid, no alteration shall be made by any company in the conditions contained in its memorandum of association.’ What is the meaning of the distinction thus drawn between a company without limit on the liability of its members and a company where the liability is limited, but, in the latter case, to assure to those dealing with the company that the whole of the subscribed capital, unless diminished by expenditure upon the objects defined by the memorandum, shall remain available for the discharge of its liabilities? The capital may, no doubt, be diminished by expenditure upon, and reasonably incidental to, all the objects specified. A part of it may be lost in carrying on the business operations authorised. Of this all persons trusting the company are aware, and take the risk. But I think they have a right to rely, and were intended by the Legislature to have a right to rely, on the capital remaining undiminished by any expenditure outside these limits, or by the return of any part of it to the shareholders. Experience appears to have shown that circumstances might occur in which a reduction of the capital would be expedient. Accordingly, by the Act of 1867, provision was made enabling a company under strictly defined conditions to reduce its capital. Nothing can be stronger than these carefully-worded provisions to show how inconsistent with the very constitution of a joint stock company, with limited liability, the right to reduce its capital was considered to be.”

On that it had been held, and was well-settled law, that where the annual receipts of a company do not exceed the expenditure, or there are no receipts at all, capital cannot be applied in the payment of dividends (*Flitcroft's case*, 21 Ch.D. 519, and *Guinness v. Land Corporation of Ireland*, 22 Ch.D. 349). It was not proposed, however, in the present case to resort to capital for the payment of dividends. The question was whether the excess of receipts over expenditure could properly be applied in payment of dividends where there was at the same time a depreciation of capital. A similar case came before the late Master of the Rolls, Sir George Jessel, in the case of *In re Ebbw Vale Steel, Iron, and Coal Company* (4 Ch.D. 827). There, at page 831, the Master of the Rolls said:—“I am very sorry that I cannot accede to this application,

which is a most reasonable one, and I have no doubt that if the Legislature amends the Act of Parliament some provision will be made for enabling the Court to do that which I think it cannot do at present. When a joint stock company has lost a portion of its capital nothing can be more beneficial to the company than to admit that loss—to write it off—and, if it chooses to go on trading, to trade with the diminished capital which remains, the dividend being declared on the capital actually remaining. The object of the present application is to authorise this to be done; that is, a portion of the share capital having been lost, it is desired that something should be written off each share, so as to make the share of less nominal value, and to enable the company—still going on trading—to pay a dividend on the amount of the capital actually remaining. But, as I understand the Companies Act 1867, such was not the object of the Act.”

It was not necessary, continued his Lordship, to give the reasons why Sir G. Jessel thought the Act of 1867 did not apply. That case having been decided in January, in July was passed the Companies Act 1877. That Act recited as follows:—“Whereas doubts have been entertained whether the power given by the Companies Act 1867 to a company of reducing its capital extends to paid-up capital, and it is expedient to remove such doubts;” and section 3 provided, “The word ‘capital,’ as used in the Companies Act 1867, shall include paid-up capital, and the power to reduce capital conferred by that Act shall include a power to cancel any lost capital, or any capital unrepresented by available assets. . . .” His Lordship believed that after the passing of that Act an order was made by the Master of the Rolls in the matter of that company authorising the reduction of capital. Speaking for himself, he had always read the passage just cited from the judgment of Sir G. Jessel as indicating his opinion to be that, where a loss of capital had occurred in a company governed by the Act of 1862, dividends could not be paid until the loss was made good. The Master of the Rolls, as his Lordship thought, regarded the Balance Sheet of such a company in the same way as that of an ordinary trading partnership. On one side would be set down the assets at their value, estimated according to the best view that could be formed. On the other side—first the liabilities, and, secondly, the capital brought in; and if there was an excess of assets over liabilities and capital, that would represent profits, out of which dividends might be declared and paid. The application of that rule in practice was not without difficulty, but that appeared to be the view adopted by the Master of the Rolls in that case and in others. It was suggested that that was too extensive an application of the passage, and that the object of the petition was not to enable dividends to be paid, but to reduce the amount of the shares, so as to make them more marketable, it being clear that shares in a company with a capital of £50,000 and paying a

dividend of 6 per cent. would fetch a better price than shares in a company with a capital of £100,000 paying a dividend of 3 per cent. If this were all that was intended, his Lordship could scarcely suppose the Legislature would have been so ready to interfere by passing the Act of 1877. However, that might be, the Act of 1877 did provide a means by which a company which had lost capital, or whose capital was to any extent unrepresented by available assets, might reduce that capital, and so be enabled to pay dividends on the reduced capital; and that had been largely done in practice. That was a consideration to which great weight ought to be given, and if his Lordship had not had the guidance of the Court of Appeal in *Lee v. Neuchatel Asphalte Company* (41 Ch.D. 1) he would, perhaps, have come to the conclusion that the only proper course would be to present a petition for reduction of capital before declaring any dividends. But, in his Lordship's opinion, that was inconsistent with the judgments delivered by the Court of Appeal in *Lee v. Neuchatel Asphalte Company*. So far as the facts went, the decision in that case did not govern the present, but when the judgments were read it appeared that the decision of the learned Judges was based upon other reasons. Lord Justice Lindley in that case said:—

“The actual point to be decided appears to me to be comparatively easy. The difficulty in the case arises from the invitation made to us by Mr. Rigby to lay down certain principles, the adoption of which would, in my judgment, paralyse the trade of the country. This company was formed in 1873, and, it may be stated shortly, was formed for the purpose of working a concession, which may be called a lease, of some asphalte mines or mineral property in Switzerland. The original lease was afterwards extended, and the company may be treated as having been formed for the purpose of acquiring a lease which will run out in 1907. It is obvious with respect to such property, as with respect to various other properties of a like kind, mines, and quarries and so on, every ton of stuff which you get out of that which you have bought with your capital may, from one point of view, be considered as embodying and containing a small portion of your capital, and that if you sell it and divide the proceeds you divide some portion of that which you have spent your capital in acquiring. It may be represented that that is a return of capital. All I can say is, if that is a return of capital, it appears to me not to be such a return of capital as is prohibited by law.”

His Lordship then read other passages from the judgments in that case, and, continuing, said it seemed to him that he must have regard to the constitution of the company, and the articles of association, and see what provisions they contained, and whether they authorised “not a mere division of profit, but a division of capital.” The objects for

which the company was established were defined in the memorandum of association :—“ III. (a) To raise money by share capital and invest the amount thereof in or otherwise acquire and hold any of the following investments (that is to say) ”—then a list of investments was given. “ (b) To borrow or raise money by the issue or sale of any bonds, mortgages, debentures, or debenture stock of the company or in any other manner ; to receive money on deposit at interest or otherwise ; and to invest the money so obtained in any such investments as aforesaid, provided that the total amount of bonds, mortgages, debentures, or debenture stock outstanding at any one time shall not exceed one-half of the amount of the share capital for the time being issued and subscribed. (c) To acquire any such investments as aforesaid by original subscription, tender, or otherwise, and whether or not fully paid up ; to make payments thereon as called up or in advance of calls or otherwise ; to subscribe for the same either conditionally or otherwise ; to vary any such investments ; and generally to sell, exchange, or otherwise dispose of, deal with, or turn to account any of the assets of the company. (d) To receive dividends, income, profits, bonuses, and advantages of every description, from time to time payable or receivable in respect of the company’s investments, and to apply the same respectively according to the provisions of the articles of association in force for the time being. (e) The capital of the company is £1,200,000, divided into 120,000 shares of £10 each, to be converted when and as from time to time fully paid up into equal moieties of preferred stock and deferred stock ; the preferred stock to be entitled to receive a preferential dividend of five per cent. per annum, not cumulative, and payable only out of the profits of each year before any dividend for such year is paid on the deferred stock.” Upon that it appeared that the object of the company was to raise money and invest it. There was a power of sale of the investments, and it might be contended that that authorised them to carry on the business of stock or share brokers. His Lordship thought that was not intended, but that the company was to be an investment company merely, and not a sharebroking company, and, in point of fact, though investments had been varied, no sharebroking business had been carried on. The clauses in the articles of association which were material were as follows :—“ 80. The share and debenture capital moneys of the company, including any moneys received from the payment off of investments or securities, shall, after paying thereout all expenses of a capital nature, be invested in investments and securities of the kinds mentioned in the memorandum of association. Provided that no purchase or acquisition of any particular security or investment shall be made by which at the current market value at the time of such purchase or acquisition, the holding of the company in such security or investment would exceed in value one-fiftieth of the subscribed share and debenture capital of the company

for the time being, but securities of different titles or denominations shall not be deemed to be one security by reason only of their being issued by or of their possessing or being entitled to a guarantee from or by the same State, Government, municipality, corporation, company, or other body. 81. The trustees shall, on making any change of investment or other financial transaction of the company, maintain as nearly as possible the relative rights and separation between capital moneys and income, and shall deal with the same accordingly, and shall have power to make all appointments necessary in that behalf. 83. An annual sum equal to one per cent. upon the first £250,000 of the share capital and debenture capital of the company for the time being subscribed and paid up, and one-half per cent. upon all such capital in excess thereof, shall be set aside by the trustees out of the revenue of the company for management expenses, and no expenses beyond that sum (other than brokerages on the share and debenture capital issued and on the purchases and sales made by the company and legal expenses) shall be incurred by them without the consent of the company in general meeting. The said sum so to be set aside as aforesaid shall include the remuneration of the trustees, who shall be entitled to receive as their remuneration any surplus of the said sum which may remain in any year after payment of all management expenses. The said remuneration shall be divided amongst the trustees as they may think fit. 84. Subject to the rights of members holding share capital issued upon special conditions, the receipts of the company from the dividends, income, profits, bonuses, and advantages payable or receivable in respect of the company's investments shall be applicable as follows:—1st. To the payment of a dividend for the particular year at the rate of 5 per cent. per annum on the preferred stock. 2nd. To the payment of such a dividend on the deferred stock as the same shall suffice to pay. And the trustees may, with the sanction of the company in general meeting, declare a dividend to be paid to the members accordingly. 85. The trustees may, before recommending any dividend, set aside out of the profits of the company such sum as they think proper as a Reserve Fund to meet contingencies or for equalising dividends or for any other purposes of the company, and may from time to time apply the whole or any part of such fund for any purposes of the company. 86. When, in the opinion of the trustees, the profits of the company permit, interim dividends not exceeding 5 per cent. per annum may be declared and paid by the board on account of the dividend for the then current year on both preferred and deferred stocks, and if the profits for the whole year shall in such case prove insufficient to pay the full dividend of 5 per cent. for such year on the preferred stock, the holders of such stock shall not be entitled to have the deficiency made up. 110. The surplus assets of the company upon the winding up thereof shall be applied first in repaying

the holders of the preferred stock the amount paid up in respect thereof, then in repaying to the holders of the deferred stock the amount paid up in respect thereof, and the residue, if any, shall be divided among the members in proportion to the nominal amount of the capital held by them respectively." The result, therefore, of not declaring dividends and putting the excess of receipts to a Reserve Fund would be to preserve the capital for the benefit of the deferred shareholders, and therefore in that respect the present company and *Lee v. Neuchatel Asphalte Company* stood upon a similar footing. Having regard to articles 80 and 81, his Lordship read the words "profits, bonuses, and advantages" in memorandum of association III. (i) and article of association 84 as meaning profits, bonuses, and advantages in the nature of incomes. The scheme appeared to be to put the shareholders for the time being in the same situation as regards dividends as were tenants-for-life under an ordinary settlement of personal property, while the persons among whom the capital would be divided in the event of a winding-up are to stand in the position of remaindermen entitled to the *corpus* of the settled property. Tenants-for-life under such a settlement would take the whole income of all duly-authorised investments, notwithstanding any shrinkage or decrease in their value, and would not be entitled to share in any augmentation of value of the *corpus*, however great that may be, or however small comparatively the corresponding increase of income. The word "profits" in articles 85 and 86 his Lordship read as meaning excess of income over expenses of management, and, so reading the word, he thought such excess was intended to be applicable for payment of dividends, notwithstanding shrinkage in the value of investments or loss of capital occasioned thereby. The investments seemed to him to constitute permanent assets—assets not to be expended in providing for the profit earned by the company within the meaning of the words of Lord Justice Cotton. These assets remained intact save by causes over which the company had no control; any diminution in their value arose from their own inherent nature, not from dealing with them by the company; it was not sought to expend a portion of them in providing for profit or dividend, and there was no likelihood of any "cheating of creditors." Under these circumstances he thought that it was not made out that payment of a dividend was beyond the power of the company. His Lordship based his decision on the peculiar nature of its constitution, and it was not to be assumed that he would have arrived at the same conclusion if he had been dealing with an ordinary trading company—*e.g.*, if the object of the company had been to carry on a stockbroker's business and the investments had been ordinary stock-in-trade. It followed, from his Lordship's view, that in this company the shareholders would not be entitled to divide for the purposes of dividend any increase in the value of the investments, however great. It was urged that if this was

so, his decision conflicted with that of Mr. Justice Chitty in *Lubbock v. British Bank of South America* (1898, 2 Ch. 198). The answer was that the nature of the two companies was different. The British Bank of South America was evidently an ordinary trading company, which the defendant company was not. In *Lee v. Neuchatel Asphalte Company*, Lord Justice Lindley said:—"I hope I am not inadvertently, certainly I am not intentionally, laying down any rule which would lead people to do anything dishonest either to shareholders or creditors." His Lordship concurred in the hope there expressed, and added that he trusted he had not misinterpreted the views of the Court of Appeal in a matter of so much importance, and that if he had done so he would speedily be set right by a higher tribunal.

The case of **VERNER v. THE GENERAL AND COMMERCIAL INVESTMENT TRUST, LIM.**

(Decided before Lords Justices LINDLEY, KAY, and SMITH, in the Court of Appeal, on 7th April 1894.)

Trust Company—Obligation of Company to provide for Depreciation in Value of its Assets before paying Dividend—"Profits"—Dividends out of Capital—Lee v. Neuchatel considered—Provisions contained in Articles of Association.

This was an appeal from a decision of Mr. Justice Stirling. It raised a very important question in company law—viz., whether, where there has been a loss in the capital of a company through depreciation in the value of its assets, the company is entitled to pay dividends out of profits earned by means of its investments without first reducing its capital so as to meet such depreciation. The action was brought by William Henry Verner, on behalf of himself and all other stockholders of the defendant company other than the directors, against the company and the directors. It came before the Court upon a motion by the plaintiff asking that the defendants might be restrained from declaring and from distributing among the members of the company any dividend in respect of the financial year of the company terminating on February 28 1894. The company was incorporated on January 26 1888, under a memorandum and articles of association, with a capital of £600,000 in 60,000 shares of £10 each, all of which had been issued and fully paid up in cash and converted into stock of two classes—preferred and deferred. In addition to its original share capital the company had borrowed £300,000 on the security of debenture stock bearing interest at 4 per cent., and secured by a floating charge upon all the

assets of the company. There had thus come to the hands of the company £900,000, which had been invested in various securities authorised by the memorandum of association. The present market value of such investments was only £654,776, showing a depreciation of £240,000. According to the evidence of the plaintiff it appeared that "of such depreciation £75,000 or thereabouts represented the amount which there was no prospect of recovering within any reasonable period of time." During the past year the receipts of the company in respect of income derived from their investments had exceeded the expenditure by upwards of £23,000. The question for the Court upon the motion was whether, there being a loss of capital to the amount of £75,000 and an excess of profits over expenditure of £23,000, a dividend could lawfully be declared and paid. The company was formed for the purpose of raising money and investing the same in various investments mentioned in the memorandum of association, and one of the objects of the company was "to receive the dividends, income, profits, bonuses, and advantages of every description from time to time payable or receivable in respect of the company's investments, and to apply the same respectively according to the provisions of the articles of association in force for the time being." The articles provided:—(84) "Subject to the rights of members holding share capital issued upon special conditions the receipts of the company from the dividends, income, profits, bonuses, and advantages payable or receivable in respect of the company's investments shall be applicable as follows:—First, to the payment of a dividend for the particular year at the rate of 5 per cent. per annum on the preferred stock; second, to the payment of such a dividend on the deferred stock as the same shall suffice to pay, and the trustees may, with the sanction of the company in general meeting, declare a dividend to be paid to the members accordingly." (85) "The trustees may, before recommending any dividend, set aside out of the profits of the company such sum as they think proper as a Reserve Fund to meet contingencies, or for equalising dividends, or for any other purposes of the company; and may from time to time apply the whole or any part of such fund for any purposes of the company." Mr. Justice Stirling, having regard to the nature of the constitution of this company, held that there was no legal obligation on the part of the company to make good the loss arising from the diminution in the value of the investments before declaring a dividend, and he dismissed the action. The plaintiff appealed.

Mr. Graham Hastings, Q.C., and Mr. Kirby were for the appellant; Mr. Buckley, Q.C., and Mr. Eve were for the respondents.

The Court dismissed the appeal.

Lord Justice Lindley delivered the judgment of himself and Lord Justice A. L. Smith as follows:—The broad question raised by this appeal is whether a limited company which has lost part of its capital can lawfully declare or pay a dividend without first making good the capital which has been lost. I have no doubt it can—that is to say, there is no law which prevents it in all cases and under all circumstances. Such a proceeding may sometimes be very imprudent, but a proceeding may be perfectly legal and may yet be opposed to sound commercial principles. We, however, have only to consider the legality or illegality of what is complained of. As was pointed out in *Lee v. Neuchatel Asphalte Company* (41 Ch.D. 1), there are certain provisions in the Companies Acts relating to the capital of limited companies; but no provisions whatever as to the payment of dividends or the division of profits. Each company is left to make out its own regulations as to such payment or division. The statutes do not even expressly and in plain language prohibit a payment of dividend out of capital. But the provisions as to capital, when carefully studied, are wholly inconsistent with the return of capital to the shareholders, whether in the shape of dividends or otherwise, except, of course, on a winding-up, and there can, in my opinion, be no doubt that even if a memorandum of association contained a provision for paying dividends out of a capital such provision would be invalid. The fact is that the main condition of limited liability is that the capital of a limited company shall be applied for the purposes for which the company is formed, and that to return the capital to the shareholders either in the shape of dividend or otherwise is not such a purpose as the Legislature contemplated. But there is a vast difference between paying dividends out of capital and paying dividends out of other money belonging to the company, and which is not part of the capital mentioned in the company's memorandum of association. The capital of a company is intended for use in some trade or business, and is necessarily exposed to risk of loss. As explained in *Lee v. Neuchatel Asphalte Company*, the capital even of a limited company is not a debt owing by it to its shareholders, and if the capital is lost the company is under no legal obligation either to make it good or, on that ground only, to wind up its affairs. If, therefore, the company has any assets which are not its capital within the meaning of the Companies Acts, there is no law which prohibits the division of such assets amongst the shareholders. Further, it was decided in that case, and, in my opinion, rightly decided, that a limited company formed to purchase and work a wasting property, such as a leasehold quarry, might lawfully declare and pay dividends out of the money produced by working such wasting property without setting aside part of that money to keep the capital up to its original amount. There is no law which prevents a company from sinking its capital in the purchase or production of a money-making property or undertaking,

and in dividing the money annually yielded by it without preserving the capital sunk so as to be able to reproduce it intact either before or after the winding-up of the company. A company may be formed upon the principle that no dividends shall be declared unless the capital is kept undiminished, or a company may contract with its creditors to keep its capital or assets up to a given value. But in the absence of some special article or contract there is no law to this effect, and, in my opinion, for very good reasons. It would, in my judgment, be most inexpedient to lay down a hard and fast rule which would prevent a flourishing company either not in debt or well able to pay its debts from paying dividends so long as its capital sunk in creating the business was not represented by assets which would, if sold, reproduce in money the capital sunk. Even a sinking fund to replace lost capital by degrees is not required by law. It is obvious that dividends cannot be paid out of capital which is lost: they can only be paid out of money which exists and can be divided. Moreover, when it is said, and said truly, that dividends are not to be paid out of capital the word "capital" means the money subscribed pursuant to the memorandum of association, or what is represented by that money. Accretions to that capital may be realised and turned into money which may be divided amongst the shareholders, as was decided in *Lubbock v. British Bank of South America* (1892, 2 Ch. 199). But, although there is nothing in the statutes requiring even a limited company to keep up its capital, and there is no prohibition against payment of dividends out of any other of the company's assets, it does not follow that dividends may be lawfully paid out of other assets regardless of the debts and liabilities of the company. A dividend pre-supposes a profit in some shape, and to divide as dividend the receipts, say, for a year, without deducting the expenses incurred in that year in producing the receipts, would be as unjustifiable in point of law as it would be reckless and blameworthy in the eyes of business men. The same observation applies to payment of dividends out of borrowed money. Further, if the income of any year arises from a consumption in that year of what may be called circulating capital, the division of such income as dividend without replacing the capital consumed in producing it will be a payment of a dividend out of capital within the meaning of the prohibition which I have endeavoured to explain. It has been already said that dividends pre-suppose profits of some sort, and this is unquestionably true. But the word "profits" is by no means free from ambiguity. The law is much more accurately expressed by saying that dividends cannot be paid out of capital than by saying that they can only be paid out of profits. The last expression leads to the inferences that the capital must always be kept up and be represented by assets which, if sold, would produce it; and this is more than is required by law. Perhaps the shortest way of expressing the distinction which I am endeavouring

to explain is to say that fixed capital may be sunk and lost, and yet that the excess of current receipts over current payments may be divided, but that floating or circulating capital must be kept up, as otherwise it will enter into and form part of such excess, in which case to divide such excess without deducting the capital which forms part of it will be contrary to law. The Companies Acts do not require even limited companies to keep accounts, still less to keep them in any particular form. The only enactment on the subject is section 26 of the Companies Act 1862, and Form D in the third schedule, and these relate solely to the nominal capital and calls. But, although this is so, yet, as a matter of business, accounts of some sort must be kept, and in order to show what has been subscribed by the shareholders and what has become of the money so subscribed, and to show the results of the company's trading or business, it is practically necessary to keep a Capital Account, and what is called a Profit and Loss Account, and as a matter of business these accounts ought to be kept as business men usually keep them. Accordingly, we find provisions for keeping such accounts in Table A in the Appendix to the Companies Act 1862 (see articles 78-82), and in the articles of association of most, if not all, companies. But there is no law which compels limited companies in all cases to recoup losses shown by the Capital Account out of the receipts shown in the Profit and Loss Account, although care must be taken not to treat capital as if it were profit. This is in accordance with *Bolton v. Natal Land Company* (1892, 2 Ch. 124), which is the latest reported case on the subject. Further, it is obvious that capital lost must not appear in the accounts as still existing intact; the accounts must show the truth and not be misleading or fraudulent. The Acts of 1867 and of 1877 are in no way inconsistent with these observations. They provide for the reduction of the nominal capital mentioned in the memorandum of association. They do not render it obligatory on a company which has lost some of its capital to reduce the nominal amount mentioned in its memorandum. There are advantages in doing so, and the Acts were passed to enable limited companies to obtain these advantages, but there is nothing in these Acts, any more than in the Act of 1862, which prevents a company which has lost part of its capital from continuing to carry on business and declaring and paying dividends. A law forbidding this may well have been considered by the Legislature far too rigid, and in their desire to check dishonest and reckless trading, Courts must be careful not to put tighter fetters on companies than the Legislature has authorised. It follows from what has been said above that the proposed payment of dividend in this particular case cannot be restrained. Mr. Justice Stirling has, in his judgment, examined the memorandum and articles of association so fully that I do not think it necessary to examine them again. It is plain there is nothing in them which requires lost capital to be made good before dividends can be

declared. On the contrary, they are so framed as to authorise the sinking of capital in the purchase of speculative stocks, funds, and securities, and the payment of dividends out of whatever interest, dividends, or other income such stocks, funds, and securities yield, although some of them are hopelessly bad, and the capital sunk in obtaining them is lost beyond recovery. There is no suggestion of any improper juggling with the accounts, and there is no payment of dividend out of capital. There is no insolvency, and we have not to deal with a petition to wind up. Some capital is lost, but that is all that can be truly said, and that is not enough to justify such an injunction as is sought. The appeal must be dismissed.

Lord Justice Kay gave judgment to the same effect.

The case of WILMER *v.* M'NAMARA & CO.

(Decided before Mr. Justice STIRLING, in the Chancery Division,
on 26th April 1895.)

*Company—Dividends—Application to restrain payment of Dividend—
Depreciation in Goodwill and Leasehold Property—Liability of Company
to make good before payment of Dividend.*

This was a motion on behalf of the ordinary shareholders of the defendant company asking for an injunction to restrain the directors from acting upon a resolution passed at a general meeting of the company, that a sum of £5,816 12s. 6d. should be applied in payment of a dividend to the preference shareholders, and also from declaring or paying any dividend for the year ending the 30th June 1894. The real object of the action, which was a friendly one, was to ascertain whether or not the dividend in question could be lawfully paid. The defendant company was formed in 1887 to acquire and develop a carrier's business previously known as Arthur M'Namara & Co., and to carry on the business of general carriers of mails, parcels, goods, &c. The capital of the company was £120,000, divided into 12,000 shares of £10 each, 7,000 of which were preference shares, carrying a fixed preferential cumulative dividend at the rate of 8 per cent. per annum, and the remaining £5,000 were ordinary shares, the holders thereof dividing all surplus profits after payment of the said preferential dividend. By an agreement dated the 8th of July 1887, the company agreed to purchase the business in question, including the goodwill, leasehold premises, horses, vans, plant, &c., thereunto belonging, for the sum of £54,000 in cash and 5,000 ordinary shares, which were to be deemed fully paid-up. The 7,000 preference shares were offered to and taken

up by the public, being fully paid-up in cash, the vendors receiving their purchase-money (£54,000) thereout. At the end of the first year of the company's existence (the 30th of June 1888) an allowance of £3,810 was made in the accounts for depreciation in the value of the leases, goodwill, and plant, and in each of the following years up to and including 1891 an allowance of £2,000 was made for the like purpose. In 1892, however, the allowance in respect of this account was only £250; but in all of these years there were substantial charges against income for van-maintenance, horses, and repairs to buildings. A valuation made for the year ending the 30th of June 1893 showed assets about £62,800, goodwill £20,000, and liabilities £12,400, leaving a balance of £70,400. No dividend was either declared or paid in this year. For the year ending the 30th June 1894 a like valuation showed a balance of £76,250, the Profit and Loss Account on that year's working showing a balance of £5,816 12s. 6d. to the good. By a resolution passed at a meeting of the company held on the 11th of September 1894, it was resolved that the said sum of £5,816 12s. 6d. should be applied in payment of a dividend to the preference shareholders. This was a motion by the ordinary shareholders to restrain the directors of the company from acting upon the said resolution, on the ground that until the loss of capital had been made up no dividends ought to be paid. The company was solvent, and the subject in dispute affected the shareholders alone. A scheme had been prepared for the reduction of the capital of the company, but it had fallen through. The real question was whether or not the proposed dividend could be lawfully paid.

JUDGMENT.

Stirling, J., after stating the facts as above set out, delivered a reserved judgment, as follows :—The nominal share capital of the defendant company amounts to £120,000, and the assets at the date of the last valuation fell short of that sum by over £43,000. Of the capital, however, only £70,000 was received in cash, the remaining £50,000 being paid over to the vendors in the form of 5,000 ordinary shares of £10 each, fully paid, in part payment of the purchase-money due to them. Under these circumstances the decision in the case of *Lee v. Neuchatel Asphalte Company* (37 W.R. 247, 41 Ch.D. 1.) applies to this extent—*i.e.*, that dividends may be paid although the assets are not sufficient to make up the nominal amount of the share capital. Beyond this, however, the case does not assist in point of decision, for in that case the assets of the company were at the period in question of greater value than they were at the date of the formation of the company. In a later case, however, *Verner v. General Investment Trust* (1894, 2 Ch. 239), the Court of Appeal laid down that in determining whether a dividend might or might not be paid by a company, regard was to be had to

the constitution of the company and its articles. Lindley, L.J., at page 265, says: "A company may be formed upon the principle that no dividend shall be declared unless the capital is kept undiminished, or a company may contract with its creditors to keep its capital or assets up to a given value, but in the absence of some special article or contract, there is no law to this effect." Here there is no such contract with creditors, and it is, therefore, only necessary to consider the articles of association, which closely resemble those in Table A to the Companies Act 1862. Article 117 provides that "no dividend shall be payable except out of the profits arising out of the business of the company." What are these profits? [Upon this point his Lordship referred at some length to the judgment of Lindley, L.J., in *Verner v. General Investment Trust* (*supra*), and continued.] Apart from the use of the word "profits" in article 117, there is nothing in the articles to show that the capital of the company (or, rather, assets of the value of those acquired by the company at its formation) must be kept up. Further, the articles appear to contemplate "profits" as the excess of receipts over all expenditure properly attributable to the year. It is necessary, however, to consider whether the depreciation in goodwill and leaseholds is to be treated as loss of "fixed" capital or of "floating" or "circulating" capital, and on this point I am of opinion that it is to be treated as loss of "fixed" capital. It very closely resembles the loss which a railway company may be said to suffer if it be found that their line, which was made, say, ten years ago, at a certain cost, could now be made at a much smaller cost. Having regard to the remarks of Lindley, L.J., in *Lee v. Neuchatel Asphalt Company* (*supra*), I think that the Balance Sheet cannot be impeached simply because it does not charge anything against revenue in respect of goodwill. I feel much more doubt whether £200 is a sufficient sum to allow in respect of depreciation of leaseholds, but I do not think under the circumstances that a case has been made out for an injunction, and the motion must be refused.

The case of THE LONDON AND GENERAL BANK, LIM.

(Decided before Lords Justices LINDLEY, LOPES, and KAY, in the Court of Appeal, on 30th April 1895.)

Liability of Auditors—Auditors as Officers of a Company—Dividends out of Capital—Companies Winding-up Act 1890, s. 10—Companies Act 1879, s. 7.

There are four appeals in this case against a judgment of Mr. Justice Vaughan Williams, by which he held that certain directors and auditors of the above company (now in liquidation) were liable to make good to

the assets of the company some large sums, which had been paid as half-yearly dividends upon the capital of the company, on the ground that those sums had not been paid out of the profits of the company, but out of the capital, and that the payments constituted a misapplication of the funds of the company, for which the directors and auditors were liable under what is known as the "misfeasance" section—section 10—of the Companies (Winding-up) Act 1890. The company was connected with what is generally known as "the Balfour Group" of companies. The appeals are brought respectively by three of the directors—Messrs. S. Walker, A. T. Layton, and S. R. Pattison—and one of the auditors, Mr. W. Theobald. Section 10 of the Companies Act 1890 is as follows:—"Where in the course of the winding-up of a company under the Companies Acts it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager, liquidator, or other officer of the company, has misapplied or retained, or become liable or accountable for, any moneys or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application of the Official Receiver, or of the liquidator of the company, or of any creditor or contributory of the company, examine into the conduct of such promoter, director, manager, liquidator, or other officer of the company, and compel him to repay any moneys or restore any property so misapplied or retained, or for which he has become liable or accountable, together with interest after such rate as the Court thinks just, or to contribute such sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance, or breach of trust, as the Court thinks just." The company was formed subsequently to the passing of the Companies Act 1879, section 7 of which provides, sub-section 1—"Once at the least in every year the accounts of every banking company registered after the passing of this Act as a limited company shall be examined by an auditor or auditors, who shall be elected annually by the company in general meeting." Sub-section 2 disqualifies directors and officers from being auditors. Sub-section 5 gives auditors right of access to books and documents. Sub-section 6 provides that the auditors shall make proper reports to the shareholders, and especially whether the Balance Sheets referred to in these reports are full and fair.

Sir E. Clarke, Q.C., and Mr. Germaine are for Mr. Walker; Mr. Herbert Reed, Q.C., and Mr. F. Low are for Mr. Layton; Mr. Cohen, Q.C., Mr. Cozens-Hardy, Q.C., and Mr. F. Whinney are for Mr. Theobald; Mr. Coleridge is for Mr. Pattison; Mr. Finlay, Q.C., Mr. E. S. Ford, and Mr. Muir Mackenzie are for the Official Receiver and liquidator.

The appeal was partly heard by their Lordships on Thursday and Friday last week. They reserved judgment until this morning on the question whether an auditor was an officer within the summary jurisdiction of the Court under section 10 of the Winding-up Act, and, upon a suggestion that some matter had been improperly admitted as evidence by Mr. Justice Vaughan Williams, intimated that they might refer it to an official referee to inquire into and report whether there had been payments of dividends out of capital.

JUDGMENT.

Lindley, L.J. : The question which has been submitted to us in this case is, whether an auditor of this bank can be properly regarded as an officer within the meaning of section 10 of the Winding-up Act of 1890. That section runs thus : "Where, in the course of the winding-up of a company under the Companies Acts, it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager, liquidator, or other officer of the company has misapplied, or retained, or become liable or accountable for any moneys or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application of the Official Receiver, or of the liquidator of the company, or of any creditor or contributory of the company, examine into the conduct of such promoter, director, manager, liquidator, or other officer of the company, and compel him to repay any moneys or restore any property so misapplied or retained, or for which he has become liable or accountable, together with interest after such rate as the Court thinks just, or to contribute such sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance, or breach of trust as the Court thinks just."

Now it is urged by Mr. Cohen that the auditor of a company is not an officer within the meaning of that section. It appears to me that in order to decide that question, we must examine and consider what an auditor is, how he is appointed, by whom he is paid, and what his duties are. This is a company—a banking company—and the auditor is required to be appointed under the Companies Act of 1879. This Companies Act of 1879 is one of the group of Acts which are usually referred to as the Companies Acts from 1862 down to, I think, 1890. Now, section 7 of this Companies Act of 1879 runs thus :—"Once at the least in every year the accounts of every banking company registered after the passing of this Act as a limited company shall be examined by an auditor or auditors, who shall be elected annually by the company in general meeting. A director or officer of the company shall not be capable of being elected auditor of such company. An auditor on quitting office shall be re-eligible. If any casual vacancy

occurs in the office of any auditor, the surviving auditor or auditors (if any) may act, but if there is no surviving auditor, the directors shall forthwith call an extraordinary general meeting for the purpose of supplying the vacancy or vacancies in the auditorship. Every auditor shall have a list delivered to him of all books kept by the company, and shall at all reasonable times have access to the books and accounts of the company; and any auditor may, in relation to such books and accounts, examine the directors or any other officer of the company. Provided that if a banking company has branch banks beyond the limits of Europe, it shall be sufficient if the auditor is allowed access to such copies of and extracts from the books and accounts of any such branch as may have been transmitted to the head office of the banking company in the United Kingdom. The auditor or auditors shall make a report to the members on the accounts examined by him or them, and on every Balance Sheet laid before the company in general meeting during his or their tenure of office; and in every such report shall state whether, in his or their opinion, the Balance Sheet referred to in the report is a full and fair Balance Sheet properly drawn up, so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company, and such report shall be read before the company in general meeting. The remuneration of the auditor or auditors shall be fixed by the general meeting appointing such auditor or auditors, and shall be paid by the company." And section 8 says "the auditors shall sign a Balance Sheet," and so on. Now reading that section alone, it seems impossible to deny that for some purposes and to some extent an auditor is an officer of the company. He is appointed by the company, he is paid by the company, and his position is described in the section as that of an officer of the company. He is not a servant of the directors. On the contrary, he is appointed by the company to check the directors, and for some purposes, and to some extent, it seems to me quite impossible to say that he is not an officer of the company.

Well, so much for the Act. If we pass to the articles of this particular company, we shall find there are some which are important. On p. 6, article 2, "Auditors and secretary" (this is the definition clause) "means those respective officers from time to time of the company." Article 73, on p. 23, runs thus: "Every director, auditor, manager, secretary, and other officer shall be indemnified by the company from all losses and expenses incurred by them respectively in or about the discharge of their respective duties, except such as happen from their own respective wilful acts or defaults." Then article 107, p. 30, runs thus (this is about the auditing): "The accounts of the company shall be from time to time examined," and so on. And then, 108, "No person shall be eligible as an auditor who is not a shareholder of the company,

or who is interested otherwise than as a shareholder or customer in any transactions of the company, and no director or officer of the company shall, during his continuance in office, be eligible as an auditor." Then, "Auditors shall be appointed at the ordinary meetings of the company each year by the shareholders present thereat, and shall only hold their offices until the ordinary meetings in every year after their appointment. Retiring auditors shall be eligible for re-election. No person, not being a retiring auditor, shall be eligible to the office of auditor unless notice of an intention to propose him at an ordinary meeting be given at least fourteen days and not more than one month before the meeting, and a copy of every such notice shall be posted up at the office during the five days next before the meeting. The remuneration of the auditors shall be determined, and may be from time to time varied, by general meetings." Then there is article 121, on page 33, "Every director, manager, auditor, trustee, member of a committee, officer, servant, agent, accountant, or other person employed in the business of the company shall, before entering upon his duties, sign a declaration pledging himself to observe a strict secrecy," and so on.

I do not think there is anything else in those articles which is material. I do not know that those articles carry the matter very much further than the section of the Act to which I have alluded, and my observations upon the articles and that Act are those which I have already made, viz., that for some purpose, and to some extent, at all events, an auditor is an officer appointed by the company, although in no sense a servant of the directors.

Then it is said—it is not denied in truth—but it is said that for all that he is not an officer of the company within the meaning of section 10. And it is put in this way, that an officer within the meaning of section 10 is an officer who, in some way or other, has control over the assets of the company. Now it is quite obvious that this section applies to something more than the misapplication of assets. Misapplication or retainer or becoming liable or accountable for the assets is provided for by the first part of the section which I have read; but, in addition to that, there is mention made of misfeasance or breach of trust in relation to the company, and, with reference to that, provision is made not by the words which authorise the Court to compel the person guilty of misfeasance or breach of trust to repay any moneys or restore any property, but to contribute such sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance, or breach of trust as the Court thinks just.

I know nothing at all about the charge against this auditor upon the facts, but suppose that an auditor whose business it is to audit accounts and sign Balance Sheets, knowing perfectly well that that Balance

Sheet so signed by him will be acted upon, shows profits properly divisible as dividend, a dividend will be declared ; and suppose that he purposely and fraudulently prepares and signs a Balance Sheet showing profits divisible when there are none. It appears to me that that is a distinct misfeasance in that sense within the meaning of that Act, leading to and intended to lead to a misapplication of the assets. Such a misfeasance, I have not the slightest doubt, would be a misfeasance within the meaning of the section. Although that does not show that he is an officer of the company, yet, having regard to the articles of association of this company and the provisions I have just referred to, I do not see how it can be said that, as a matter of law, this gentleman is not an officer of the company and cannot be liable for misfeasance. In my opinion he is an officer, and may be within the misfeasance contemplated by section 10.

Now, it is said that that is very hard upon persons who are auditors, and that if they are guilty of negligence, fraud, or misconduct, the proper way is by an action. But suppose an action were brought against an auditor upon the ground that the accounts had been fraudulently audited, how could that be possibly tried by a jury? It would demand and would necessitate a prolonged investigation of the accounts, and no one who has any experience of trial by jury would for a moment pretend that it could be so tried, and therefore it must be referred to some other tribunal. Therefore, the point made by Mr. Cohen that you are going to deprive him of his constitutional right really does not apply, and it appears to me that the objection fails, and therefore we are not prepared to say, and cannot say, that the auditor of a company in a case like this is not an officer of the company within section 10.

Lopes, L.J. : I am of the same opinion. The question is whether an auditor, such as the auditor in this case, is an officer within the true meaning of section 10. I do not propose to read the section again, which has already been read, but it is to be observed in respect of this section that it does not create any new rights, but it gives a very summary mode of procedure in enforcing rights already existing. Now, if it were not for the word "misfeasance" in section 10, I should not have thought that an auditor, such as the auditor in the present case, came within the meaning of that section.

I should have thought that the section, if that word had been absent, was rather directed against those who had to carry out the business and purposes of the company, who had the control over the assets of the company, who had the conduct of the business, and who might have the money or the property of the company in their hands, which they might apply, retain, or restore. But I find the word "misfeasance," and, as I understand the word "misfeasance" in this section, it means a breach

of duty. Now, if it means a breach of duty, one can quite understand a breach of duty which might be committed, which might be effected, by an auditor. For instance, he might, in collusion with his directors, prepare a false account, which would involve a misapplication of the assets. Now, in such a case, it seems to me that that would be one of the mischiefs which this section was intended to prevent. I come, therefore, to the conclusion that an auditor, such as that of a banking company, is an officer within the meaning of that section. And I am fortified in that view by the words of the section of the Companies Act of 1879, because, it seems to me, that that section recognises the auditor of a banking company, and recognises the auditor of a banking company as an officer. If you look at the subsection, it says: "If any casual vacancy occurs in the office of auditor"; and throughout, the section seems to contemplate that the auditor is an officer of the company. That fortifies the view that I have formed with regard to section 10, and I am also confirmed in that view by the fact that the articles of association of this very banking company recognise the auditor as an officer. Now, there was a case referred to, which is a case *In re The Liberator Permanent Benefit Building Society*, which came before Mr. Justice Cave and Mr. Justice Collins, and I find it reported in the 71st volume of the *Law Times*, on page 406). That was not a case of an auditor. That was the case of a solicitor. It was not the case of a banking company, but of a building society. And it is true that Mr. Justice Cave, in the course of his judgment, says: "It seems to me that merely because he was appointed solicitor to the society, without more, the solicitor does not become an officer to the society any more than it has been held that a banker does, if he is appointed banker to the society, or a broker if he is appointed broker to the society, or the auditor if he is appointed auditor to the society." I do not think that the attention of Mr. Justice Cave was drawn to the word "misfeasance"; but, however that may have been, that was not a case of an auditor, but the case of a solicitor, that had been decided; and it may be again said that the section of the Act of 1879 which relates to the auditor of a banking company, would not relate in the same way to a solicitor, and, for anything I know (I have not been able to find it out), it does not appear that the articles of association, so far as I can see, recognise the auditor as an officer. I come, therefore, to the conclusion that the auditor of this banking company was an officer within the true meaning of section 10 of the Companies (Winding-up) Act of 1890.

Kay, L.J.: I come to the same conclusion, but I wish to guard myself against being understood to hold that, in every case of a joint stock company, the auditor employed by the joint stock company is an officer of the company. I do not at present hold that opinion; I can quite conceive there may be one or two cases of a joint stock company

who call in an auditor to make a particular audit, where the auditor called in could not be properly treated as an officer of the company ; but we have got to deal in this case with a joint stock company—a banking company limited—whose duties, in respect of having their accounts audited, are prescribed by the Act of 1879, to which reference has been made. And it will be observed, on looking at that Act of Parliament, section 7, that the auditor is to be appointed by the company in general meeting. The first subsection of section 7 says that “ Once at least in every year the accounts of every banking company registered after the passing of this Act as a limited liability company shall be examined by an auditor or auditors, who shall be elected annually by the company in general meeting.” So that the election is not like the election of the ordinary officers of the society—delegated to the directors of the company, but it is prescribed by statute that there shall, in this case, be an auditor elected by the company in general meeting. Then I find, turning to the articles of this society, that they recognise distinctly their duty, and by the interpretation clause of their articles they do define expressly that the auditor of this company shall be an officer of this company. The words have been read, but I will just refer to them again for a moment. The first of the articles is: “ Auditors and secretary means those respective officers from time to time of the company.” Then, again, we find in section 73 a recognition of the fact that auditors duly appointed by the company are officers of the company ; and then come the sections which speak of the duties of auditors, section 107 and section 108 ; and section 108 (some comments were made with regard to the words and the language of that section) provides that no director or officer of the company shall, during his continuance in office, be eligible as auditor. It was said that that shows plainly that an auditor is not to be an officer of the company but somebody who is not an officer. I do not read it in that sense. That is a mere copy of the language of the Act of 1879, which provides in section 7, subsection 2, that “ a director or officer of the company shall not be capable of being elected an auditor of such company.” Here the auditor is treated as an officer of the company. They provide also in their articles that the auditor shall not hold any other office in the company. At the same time, I take article 108 not to contradict that which has been said in the earlier part of these articles, that an auditor of this company is an officer of the company, but merely to provide, as the statute provides, that while he is an auditor he shall not hold any other office in the company. The object of that section is that he might not hold some other office the duties of which might bias him in his conduct as an auditor ; and, therefore, to prevent the danger of that it is provided by the statute, and repeated by the articles, that he cannot hold at the same time any other office of the company. That seems to me to reconcile these articles with the statute, and, dealing with this particular

clause, which is all we have got to consider now, I come to the conclusion that in this case the company in its constitution recognised the necessity of having auditors duly appointed under the statute of 1879, and made these provisions that auditors so appointed should be treated by this company as being officers of the company. In the face of that it seems to me quite impossible to hold that auditors are not officers of the company. Then whether they are officers within section 10 or not, seems to be almost concluded when you come to the opinion that this company did appoint its auditors as officers of the company. For, after all, all the section provides is only a convenient mode of dealing with, amongst other things, the misapplication of the funds of the company by its officers. On the other hand also, for misfeasance (misfeasance other than misapplication of the money of the company which may lead to an injury and damage to the company, and which is to be met, not by replacing the misappropriated funds, but as the section says by compensation to the company) the words "misfeasance" and "compensation," as used in that section, seem to me to be clearly correlative; and when that section speaks of the misfeasance of an officer of the company, it must mean, looking to the collocated words, misfeasance other than the misapplication or misappropriation of the funds or property of the company. And to remedy that misfeasance the power which that section gives requires that persons convicted of misfeasance shall make compensation to the company. As has been said by Lindley, L.J., the possibility of misfeasance by an auditor might produce very considerable damage and injury to the company of which he was auditor, and in that case it seems to me that he does come within the section, and that as I read the terms of this section 10 he can be made liable for such misfeasance, and can be obliged to make compensation to the company, and I therefore think that that must be our ruling.

Lindley, L.J.: Now the next question is, What ought to be done with reference to the hearing of this appeal? And it has given us a great deal of trouble and anxiety to decide what is to be the right manner of dealing with it. We were very much impressed by the observations made by Sir Edward Clarke, that the learned Judge had, apparently, acted upon materials which were not in evidence before him, and which the parties had had no opportunity of answering, or being heard upon, and before making up our minds as to what was to be done we thought it right to communicate with the learned Judge himself to ascertain what the real facts were. Now he has reported to us, as to the observations made by him on pp. 27 and 28 of his printed judgment, that what took place was this—that he went through the books of this company himself, and came to certain conclusions which he desired to have further information upon, and he checked them to verify them. He did that, and then with the consent which we heard of

the other day, asked for, and obtained, the assistance of Mr. Bramall and of Mr. Avery, and they prepared things called "schedules," which I confess I have not examined, and the learned Judge says that those "schedules" consisted substantially of two parts, some central columns which contained only what could be got out of the books of this company, and which were strictly in evidence, and they were accompanied by remarks and observations in other parts, and the documents which were before him; and he informs us that he discarded everything except that which was properly evidence in the case, but that having seen these observations he did not think it fair or right not to inform the parties that he had done so, and that explains this passage in his judgment to which reference has been made.

Now, under these circumstances, we are clearly of opinion that the very last thing we ought to do is to refer this either for a new trial or to an official referee, thereby putting the parties to the expense of going through the whole thing again, unless we are actually driven (when we suggested that course the other day we thought we should be driven) to adopt it, but, having received the observations of the learned Judge, we feel that it is our duty to hear the appeal ourselves, putting upon the appellants the ordinary burthen of showing that the decision is wrong, we attending only to what is legitimate evidence in the case. We propose, therefore, to fix a day, say, the 20th May, to hear the appeal in the ordinary course. If it should become necessary in the course of the appeal to adduce further evidence we have ample power to do it, and we shall exercise our own judgment; but at the same time, it is a course which, we think, we ought not to take unless we are absolutely driven to it.

It was subsequently decided to hold over the appeal until the second day of next sittings.

The case of THE LONDON AND GENERAL BANK, LIM.

(Decided before Lords Justices LINDLEY, LOPES, and RIGBY, in the Court of Appeal, on 6th August 1895.)

Payment of Dividends out of Capital—Liability of Auditors.

JUDGMENT.

Lord Justice Lindley: This is an appeal by Mr. Theobald, one of the auditors of the London and General Bank, which is being wound up, against an order made by Mr. Justice Vaughan Williams, under section 10 of the Companies Act 1890. By this order Mr. Theobald and the directors of the bank are declared jointly and severally liable to pay to

the Official Receiver of the company two sums of £5,946 12s. od. and £8,486 11s. od., being respectively the amounts of dividends declared and paid by the bank for the years 1890 and 1891, with interest on those sums. The grounds on which this order was made on Mr. Theobald are that these dividends were paid out of capital, and that such payment was made pursuant to resolutions of the shareholders based upon recommendations of the directors of the bank, and upon Balance Sheets prepared and certified by Mr. Theobald, and which did not truly represent the financial position of the company.

Mr. Theobald's appeal was supported by arguments to the effect (1) that Mr. Theobald was not an officer of the company within the meaning of section 10 of the Winding-up Act 1890; (2) that the Balance Sheets and certificates given by Mr. Theobald were in accordance with the books of the bank, and that Mr. Theobald's duty as auditor was confined to framing the Balance Sheets, which showed the position of the bank as disclosed by its books, (3) that the dividends in question were not really paid out of capital, and that however imprudent and reckless it may have been to pay them, Mr. Theobald, as auditor, is not legally responsible for such payment; (4) that even if Mr. Theobald, as auditor, failed adequately to discharge his duty, and even if the dividends were paid out of capital, his failure to discharge his duty was the remote and not the proximate cause of the non-payment of the dividends, and that he, consequently, is not legally liable to make good the amount so paid; (5) that at any rate the order is wrong in declaring him liable jointly and severally with the directors to repay the dividends in question.

The first of these contentions was argued and decided last April, and the Court then held that an auditor of a banking company governed by the Companies Act 1879, and by such articles as regulated the present company, was an officer of the company within the meaning of section 10 of the Winding-up Act 1890, and was liable to have proceedings taken against him under that section. This point, having been thus decided, was, of course, not again raised, and nothing further need be said about it.

It remains, however, to consider what the duties of an auditor are as respects companies governed by the Companies Act 1879, and by such articles as regulate this particular company. It will be convenient to do this before examining the facts relied upon by the liquidator as making Mr. Theobald liable to make good the dividends which he has been ordered to pay. Section 7 of the Companies Act of 1879, clauses 1, 5, and 6, are material. "7 (1) Once at the least in every year the accounts of every banking company registered after the passing of this Act as a limited company shall be examined by an auditor or auditors, who shall be elected annually by the company in general meeting."

Then clause 5 is :—“ Every auditor shall have a list delivered to him of all books kept by the company, and shall at all reasonable times have access to the books and accounts of the company ; and any auditor may, in relation to such books and accounts, examine the directors or any other officer of the company.” Then there is a proviso, which one need not read, about banks beyond the limits of Europe. Then 6 is :—“ The auditor or auditors shall make a report to the members on the accounts examined by him or them, and on every Balance Sheet laid before the company in general meeting during his or their tenure of office ; and in every such report shall state whether, in his or their opinion, the Balance Sheet referred to in the report is a full and fair Balance Sheet properly drawn up, so as to exhibit a true and correct view of the state of the company’s affairs, as shown by the books of the company, and such report shall be read before the company in general meeting.” Then “ 7. The remuneration of the auditor or auditors shall be fixed by the general meeting appointing such auditor or auditors, and shall be paid by the company.” It is necessary also to read Articles 106, 107, and 114. Article 106, which is under the head “ Accounts,” runs thus :—“ At every ordinary meeting the directors shall lay before the meeting a Balance Sheet showing the financial state of the company for the previous financial year, duly audited, and every such Balance Sheet shall be accompanied by a report of the directors as to the state and condition of the company, and as to the amount which they recommend to be paid out of the profits by way of dividend or bonus to the shareholders, after allowing for any interim dividend which the directors may have declared, and any sum which they may have set aside under Article 116 hereof.” Then Article 107, which is under the head “ Audit,” runs thus :—“ The accounts of the company shall be from time to time examined and the correctness of the statements shall be from time to time ascertained, by two or more auditors, in accordance with these presents.” Then Article 114, which, I think, is the only further one I need read at this moment, runs thus :—“ The auditors shall be supplied with copies of the statement of accounts intended to be laid before the meeting, and it shall be their duty to examine the same with the accounts and vouchers relating thereto.” These are the enactments and regulations which bear directly on the duties of the auditors, and although Articles 107 and 114 are in terms more explicit than section 7 of the statute as regards the duty of the auditors to examine and ascertain the correctness of the statements laid before them, and of the accounts laid before the shareholders, yet it is tolerably plain from the language of section 7 of the Act, clause 5, that the articles add little, if anything, to the duties imposed on the auditors by the statute alone.

In connection with these articles, and in order to save repetition, it

should be stated that by the articles of this bank it is the duty of the directors, and not of the auditors, to recommend to the shareholders the amounts to be appropriated for dividends; and it is the duty of the directors to have proper accounts kept so as to show the true state and position of the company. Lastly, it is for the shareholders, but only on the recommendation of the directors, to declare a dividend.

It is impossible to read section 7 of the Companies Act 1879 without being struck with the importance of the enactment that the auditors are to be appointed by the shareholders, and are to report to them directly, and not to, or through, the directors. The object of this enactment is obvious. It evidently is to secure to the shareholders independent and reliable information respecting the true financial position of the company at the time of the audit. The articles of this particular company are even more explicit on this point than the statute itself, and remove any possible ambiguity to which the language of the statute, taken alone, may be open if very narrowly criticised.

It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question: How is he to ascertain such position? The answer is: By examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books of the company themselves show the company's true position. He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than a farce. Assuming the books to be so kept as to show the true position of the company, the auditor has to frame a Balance Sheet showing that position according to the books, and to certify that the Balance Sheet presented is correct in that sense. But his first duty is to examine the books, not merely for the purpose of ascertaining what they do show, but also for the purpose of satisfying himself that they show the true financial position of the company. This is quite in accordance with the decision of Mr. Justice Stirling in *The Leeds Estate Company v. Shephard*, in 36 Chancery Division, page 802. An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not guarantee that his Balance Sheet is

accurate according to the books of the company. If he did he would be responsible for an error on his part, even if he were himself deceived, without any want of reasonable care on his part—say, by the fraudulent concealment of a book from him. His obligation is not so onerous as this.

Such I take to be the duty of the auditor ; he must be honest—that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.

What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion, very little inquiry will be reasonable and sufficient ; and in practice, I believe, business men select a few cases haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary, but still an auditor is not bound to exercise more than reasonable care and skill even in a case of suspicion ; and he is perfectly justified in acting on the opinion of an expert where special knowledge is required.

Mr. Theobald's evidence satisfies me that he took the same view as myself of his duty in investigating the company's books and preparing his Balance Sheet. He did not content himself with making his Balance Sheet from the books without troubling himself about the truth of what they showed. He checked the cash, examined vouchers for payments, saw that the bills and securities entered in the books were correct, took reasonable care to ascertain their value, and in one case obtained a solicitor's opinion on the validity of an equitable charge. I see no trace whatever of any failure by him in the performance of this part of his duty. It is satisfactory to find that the legal standard of duty is not too high for business purposes, and is recognised as correct by business men.

The Balance Sheet and certificate of February 1892, that is, for the year 1891, was accompanied by a report to the directors of the bank. Taking the Balance Sheet, the certificate, and report together, Mr. Theobald stated to the directors the true financial position of the bank, and if this report had been laid before the shareholders, Mr. Theobald would have completely discharged his duty to them. Unfortunately, however, this report was not laid before the shareholders, and it becomes necessary to consider the legal consequences to Mr. Theobald of this circumstance.

A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more. Information and means of information are by no means equivalent terms. Still,

there may be circumstances under which information given in the shape of a printed document circulated amongst a large body of shareholders would by its consequent publicity be very injurious to their interests, and in such a case I am not prepared to say that an auditor would fail to discharge his duty, if instead of publishing his report in such a way as to ensure publicity, he made a confidential report to the shareholders, and invited their attention to it, and told them where they could see it. The auditor is to make a report to the shareholders, but the mode of doing so, and the form of the report, are not prescribed. If, therefore, Mr. Theobald had laid before the shareholders the Balance Sheet and the Profit and Loss Account accompanied by a certificate in the form in which he had prepared it, he would perhaps have done enough, under the peculiar circumstances of the case. I feel, however, the great danger of acting on such a principle, and in order not to be misunderstood, I will add that an auditor who gives shareholders means of information instead of information in respect of a company's financial position does so at his peril and runs the very serious risk of being held, judicially, to have failed to discharge his duty.

In this case I have no hesitation in saying that Mr. Theobald did fail to discharge his duty to the shareholders in certifying and laying before them the Balance Sheet of February 1892, without any reference to the report which he laid before the directors, and with no other warning than is conveyed by the words "The value of the assets as shown on the Balance Sheet is dependent upon realisation." The most important asset on that Balance Sheet is put down as "Loans to customers and other securities, £346,975," and on those a full and detailed report was made to the directors, showing the very unsatisfactory state of these loans and securities, and it is impossible to read the oral evidence, the report of Mr. Balfour and Mr. Brock, dated the 22nd of December 1891, and the report of the auditor to the directors of the 3rd of February 1892, without coming to the conclusion that the entry of that large sum as a good asset without explanation was unjustifiable. It is a mere truism to say that the value of loans and securities depends upon their realisation. We are told that a statement to that effect is so unusual that the mere presence of those words is enough to excite suspicion. But, as already stated, the duty of an auditor is to convey information, not to arouse inquiry, and although an auditor might infer from an unusual statement that something was seriously wrong, it by no means follows that ordinary people would have their suspicions aroused by a similar statement if, as in this case, its language expresses no more than any ordinary person would infer without it.

But Mr. Theobald relies on the fact that he was induced to omit from his certificate all reference to the report which he made to the directors, because Mr. Balfour, the chairman, promised to mention such report

in his speech to the shareholders, and he did so. But although Mr. Balfour twice alluded to the report, he did so in such a way as to avoid attracting attention to it. The second time he mentioned it was after a dividend had been declared, and when a motion to re-appoint the auditors was before the meeting. The truth is that not a word was said to convey to the shareholders the substance of the information contained in the report, or to induce them to ask any question about it. The Balance Sheet and the Profit and Loss Account were true and correct in this sense, that they were in accordance with the books. But they were, nevertheless, entirely misleading, and misrepresented the real position of the company. Under these circumstances, I am compelled to hold that Mr. Theobald failed to discharge his duty to the shareholders with respect to the Balance Sheet and certificate of February 1892. Possibly he did not realise the extent of his duty to the shareholders as distinguished from the directors, and he, unfortunately consented to leave the chairman to explain the true state of the company to the shareholders instead of doing so himself. The fact, however, remains, and cannot be got over that the Balance Sheet and certificate of February 1892 did not show the true position of the company at the end of 1891, and that this was owing to the omission by the auditor to lay before the shareholders material information which he had obtained in the course of his employment as auditor of the company, and to which he called the attention of the directors.

But then it is contended that, even if this be so, there was, after all, no payment of a dividend out of capital ; and further that, even if there was, still that such payment was not the natural or immediate result of Mr. Theobald's certificate, and of the accounts which he prepared.

Whether the payment was made out of capital or not is a question of fact. It was professedly made out of profits made by the bank by charging its customers with interest and commission on loans and discounts. The books showed such profit, but the question is where did the money come from with which the dividends were paid? The money came from cash at the bankers or in hand, but this cash could not be properly treated as profit, and the directors and auditors knew this perfectly well. This part of the case has been most carefully investigated by the learned Judge whose decision we are reviewing, and after attending most attentively to the observations of counsel on the reasonings and conclusions contained in the judgment appealed from, I see no reason whatever for dissenting from them. On the contrary, I entirely agree with him in saying that the profits for the year 1891 never really existed except on paper—that, to use his words, "Whatever may be the right line to draw as to when profit not received may be carried to profit for the purpose of the annual Revenue Account, it is plain that there was no justification for so doing in the present case." The real truth

is that the assets of the bank were put down in the Balance Sheet at far too high a figure, and this entry, though not misleading if explained (as it was to the directors), was seriously misleading in the absence of explanation. Mr. Theobald says that he regarded the assets of the bank as only locked up, but his report and the schedule to it go far beyond this. The value of the principal asset depended on the probability of the Balfour group of companies and some of the other large borrowers repaying their loans. They were financing each other, their indebtedness to the bank increased largely during the year, the securities held by the bank for these loans were, to say the least, of very doubtful character, and yet the total amount due to the bank in respect of these loans is inserted in the Balance Sheet as a good asset without any deduction, and without a word of explanation to the shareholders. We now know that these assets have realised a comparatively small sum, and we were very properly warned against the danger of doing injustice by being wise after the event. But disregarding the result of realisation and attending only to what was known to the auditors in February 1892, the entry in the Balance Sheet of the sum of £346,975 as a good asset was wholly unjustifiable unless explained.

We are now in a position to understand the true meaning of a passage contained in the auditors' report to the directors of the 3rd February 1892, and which runs thus: "We cannot conclude without expressing our opinion unhesitatingly that no dividend should be paid this year." I find it impossible to treat this as a statement by the auditors that there are profits divisible among the shareholders, but that the auditors cannot recommend a dividend. I can only regard the passage as meaning that there are no funds out of which the dividend can properly be paid, and, therefore, no dividend ought to be paid this year. A dividend of 7 per cent. was, nevertheless, recommended by the directors, and was resolved upon by the shareholders at a meeting furnished with the Balance Sheet and Profit and Loss Account certified by the auditors, and at which meeting the auditors were present, but silent. Not a word was said to inform the shareholders of the true state of affairs. It is idle to say that these accounts are so remotely connected with the payment of the dividend as to render the auditors legally irresponsible for such payment. The Balance Sheet and account certified by the auditors as showing a profit available for dividend were, in my judgment, not the remote, but the real operating cause of the motion for the payment of the dividend which the directors improperly recommended. The auditors' account and certificate gave weight to such a recommendation and rendered it acceptable to the meeting. It was wholly unnecessary for the Official Receiver to call a shareholder to say that he was induced by the auditors' certificate to concur in the resolution to pay a dividend. As to this part of the case, *res ipsa loquitur*.

The point was made that the form of the order was wrong. But there was nothing in this. Mr. Theobald could obviously be sued alone in an action at law for breach of his statutory duty as auditor, and the measure of damages would be the sum which he has been ordered to pay. Whether a similar action at law could be maintained against him and the directors jointly is more open to question. I am by no means satisfied that it could not, seeing that the wrongful payment of the dividend was caused by his improper certificate and accounts, and by the use made of them by the directors. But, be this as it may, there was a clear breach of trust by the directors, facilitated, and, indeed, only rendered possible by the auditor, who failed in discharging his own duty to the shareholders; and I have no doubt that in equity both he and they could be held jointly and severally liable for the misapplication of the company's moneys, which constituted a breach of trust. In respect, therefore, to the sum of £8,486 11s. wrongfully paid as dividend in 1892 in respect of the alleged profits made in 1891, the appeal in my opinion fails.

I pass now to the accounts and Balance Sheet prepared by the auditors in February 1891, and showing the state of affairs in 1890. A profit for that year was shown, and a dividend of £5,946 12s. was declared and paid, and Mr. Theobald has been held liable for this sum also. I agree with Mr. Justice Vaughan Williams in holding that the dividend for 1890 was in fact improperly declared and paid. But the evidence that Mr. Theobald was guilty of any breach of duty in certifying the accounts in February 1891 is far less cogent than that which presses so heavily against him with reference to the accounts of February 1892. The truth is that the conviction that the bank's affairs were every year getting worse and worse grew upon him year by year. This state of things was shown by the decrease of its reserve capital, and the increase of its loans to customers. But the loans to customers were, speaking roughly, £100,000 less at the end of the year 1890 than at the end of 1891, and seeing that the accounts prepared by the auditors did accurately represent the position of the company as shown by the books, and that it is not proved that Mr. Theobald really knew, or ought then to have known, that the position of the bank was not correctly shown by the books, I think Mr. Justice Vaughan Williams has gone too far in holding Mr. Theobald liable for this sum. The reasons which induced the learned Judge to decide that Mr. Theobald was not liable for the dividends paid in 1889 and 1890 appear to me to apply also to the dividends paid in 1891 in respect of the profits of 1890. No doubt the change made by the auditors in 1886 in the form of the certificate they gave is really significant, and, unexplained, leads to the inference that the auditors did not believe that the books of the company and the Balance Sheet prepared from them correctly showed the

position of the bank. But Mr. Theobald's evidence does, in my opinion, show that in February 1891 matters were not known or believed to be so bad as to lead him to the conclusion that there were then no profits out of which a dividend could properly be paid. It is true that the position of the bank was very unsatisfactory in 1890, and the auditors knew it to be so. This, however, appeared from the Balance Sheet and accounts which they laid before the shareholders. It is known now that the assets were put down at too high a figure; but it is not proved that the auditors knew it or ought to have known it. The Balfour group of companies, though dependent upon each other, were by no means in so tottering a state as they were a year later. Mr. Wilkinson's debt was still treated by the directors as bearing interest and as a good, or at all events not a bad, debt. Mr. Benham's debt was unsatisfactory, but the auditors can hardly be blamed for treating it as good, having regard to the solicitor's statement as to the security held for it. This part of the case is very near the line, but having carefully considered it, I do not think that the evidence is sufficiently strong to establish a case of misfeasance on the part of Mr. Theobald in February 1891. I am not satisfied that he was then guilty of more than an excusable error of judgment; although now that all the facts are known the error is seen to have been very serious in its consequences. As to the sum of £5,946 12s. od., therefore, the appeal must be allowed. As regards costs, Mr. Theobald's appeal has resulted in reducing the sum for which he has been held liable; but, in other respects, and as regards his main contention, it has failed. Under these circumstances he ought not to receive or pay any costs of the appeal, and the only order as to costs will be that the Official Receiver be paid his costs out of the assets of the company.

Lord Justice Lopes has read and considered this judgment and concurs in it.

Lord Justice Rigby: I have had the advantage of reading and considering the judgment just delivered by Lord Justice Lindley, and I might have confined myself to saying I concur in it, but as I have gone carefully into the evidence as against the appellant, I think that I shall do well to show how I have come to the conclusion on which my judgment is founded. I shall not attempt to repeat all that is contained in Lord Justice Lindley's judgment. Where no reference is made to a particular topic it must be taken that I have nothing to add, though I do not wish to detract from anything said. The appeal is against that part of the order of the 20th December 1894 of Mr. Justice Vaughan Williams, which finds Mr. Theobald liable as one of the auditors of the London and General Bank, Lim., to make good to the assets of the company, jointly with other persons, and severally, the amount with interest from the date of the order of two sums, £6,768 6s. 9d. and

£9,328 17s. 4d., being the dividends with interest thereon down to the date of the order recommended by the directors and declared by meetings of the company in the years 1891 and 1892 for the years 1890 and 1891. I have not taken the same figures as Lord Justice Lindley did because there has been added to the dividends the amount of interest down to the date of the order. I think it will be the exact figure.

The order was made on a summons taken out by the liquidator of the company in the matter of the Companies Acts and in the matter of the bank, asking, so far as is material for the present appeal, for a declaration of the joint and several liability of the directors and auditors of the company on the ground that the dividends before mentioned were not paid out of profits but out of capital, and so far as the auditors were concerned on the ground that they certified and reported that the Balance Sheets which were laid before the company at the said meetings purported to show profits in excess of the sum paid as dividends. I understand the application to have been in substance an application against the auditors as officers of the company under the 10th section of the Act of 1890 to compel them to contribute to the assets of the company by way of compensation for their misfeasance such sums as the Court may think just.

The main issues, therefore, seem to be whether the auditors have been guilty of any misfeasance in relation to the company; whether the misfeasance has occasioned loss to the company for which compensation ought to be directed to be made. This will involve the question whether the dividends were, in fact, paid, not out of profits, but out of capital, and whether such payment was the fault of the auditor. Then there will be the question of the amount of compensation which ought to be directed. To determine the first question, I think it will be necessary to consider in some detail the position and duties of the auditors, what they ought to have done, and what they have done. Then I refer to subsection 6 of section 7 of the Companies Act of 1879, and to those articles of association which have been referred to by Lord Justice Lindley. I do not think it necessary here to read them out. The articles of association cannot absolve the auditors from any obligation imposed upon them by the statute, and it may be that they do not in this case impose any greater obligations as to the Balance Sheet, though they make it clear that similar obligations extend to all accounts placed before the company, including the Profit and Loss Account as well as the Balance Sheet. Under the statute, the members of the company are entitled to have the safeguard of an expression of opinion of the auditors to the effect, first, that the Balance Sheet is a full and fair Balance Sheet, and, secondly, that it, the Balance Sheet, is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs. The words "as shown by the books of the company" seem to me to be

introduced to relieve the auditors from any responsibility as to affairs of the company kept out of the books and concealed from them, but not to confine it to a mere statement of the correspondence of the Balance Sheet with the entries in the books. Now, a full and fair Balance Sheet must be such a Balance Sheet as to convey a truthful statement as to the company's position. It must not conceal any known cause of weakness in the financial position or suggest anything which cannot be supported as fairly correct in a business point of view. The provision as to the Balance Sheet being properly drawn up so as to exhibit a correct view of the state of the company's affairs is taken from, though it does not go quite so far as Article 94, Table A, of the schedule to the Companies Act of 1862. Treated as an addition to the requisition of a full and fair Balance Sheet, it may not be easy to define the full extent of the obligation which it imposes, nor is it necessary to do so in this case, for it certainly requires, as will hereafter appear, a more detailed statement of facts, or a more detailed explanation of the affairs of the bank, than is contained in any of the Balance Sheets of this company.

It will be important to see what information the auditors actually acquired as to the business of the company, and the way in which they reported upon the successive Balance Sheets. Mr. Theobald and Mr. Timms were auditors of the bank from its incorporation in 1882, and they made the audit for successive years down to and including the audit for 1891.

The reports of the auditors to the members always took the form of a certificate or memorandum written on the Balance Sheet for the year. Their reports on the accounts for the years 1882 and 1883 contained a statement to the effect that in their opinion the Balance Sheet exhibited a true and correct view of the position of the bank. In their report on the accounts of 1885 a somewhat less emphatic statement to the same effect appears, but in the subsequent report no such statement is to be found. In a report to the directors dated the 11th February 1886, which refers to the accounts for 1885, Mr. Theobald, after noticing that the first-class investments, kept by bankers for quick realisation in case of need, stood at a considerably reduced sum, and that more than the whole capital of the company was invested in four accounts, viz., the accounts of the Liberator, the Lands Allotment Company, the House and Land Company, and the Building Estates Company, and that these investments could not be easily realised in critical times, proceeds to say—"You are doubtless aware that it is a rule with bankers to have at hand in cash or easily realisable securities an amount equal to at least one-third of the customers' current accounts. Considering the whole amount of uncalled capital, I consider that in this case the proportion is scarcely sufficient." There can be no doubt that even at this time

Mr. Theobald was aware that the state of affairs of the bank was unsatisfactory in the important points of lock-up of capital and consequent deficiency of realisable securities. At this date the cash in hand appeared to be £28,000—I only give the round figures—and the easily realisable securities were worth £12,600, making together £41,000 odd, while the current accounts and deposit accounts of customers together reached £107,000. I have not been able to distinguish the separate amounts of current and deposit accounts at that time. In the Balance Sheet for 1891, more particularly dealt with hereafter, the cash had fallen to £25,000, and the easily realisable securities to £7,820, making together £32,820 odd; hardly more than one-sixth of the sum due to customers on current accounts alone, which had increased to £189,000 odd, the amount due on current and deposit accounts taken together being £282,000. No other report of the auditors to the directors is put in evidence until that of 1892 as to the accounts of 1891. The report of the auditors to the members on the accounts for 1886 to 1890, both inclusive, are simply to the effect that the cash and bills receivable are correct, that securities had been produced for the investments and loans (no information being given as to the securities so produced), and that the Balance Sheet is a correct summary of the accounts recorded in the books. In the last-mentioned report is contained for the first time a statement, “The value of the assets as shown on the Balance Sheet is dependent on realisation.”

Great stress has been laid on this by counsel for the appellants. They argue that it was sufficient to put members upon inquiry, and that from the course taken at the trial they were debarred from giving the evidence of experts as to the importance and signification of this. I may at once say that it was the duty of the auditors to convey in direct and express terms to the members any information which they thought proper to be communicated, that the words of the statement are perfectly clear in their meaning, but also entirely unimportant, amounting to a mere truism, and that no evidence of experts would have been of the slightest use for the purpose of giving them a greater importance or signification than they possessed in themselves, even if such evidence were admissible. To me it appears that all the reports from 1886 onwards were imperfect, and that the auditors in giving reports in such form failed entirely to fulfil the statutory duties imposed upon them. Counsel for the appellants argued that such a failure would not amount to misfeasance but only to negligence, and that the appellant is not charged by the summons with negligence, but I cannot admit the cogency of this argument. The reports were made in order to fulfil the statutory obligation, and to be read to the meetings in accordance with the statute. Mr. Theobald, with reference to this matter, says at page 74 of the evidence, “My certificate means the same as the Act.” Then

he is asked, "Do you say you could have given the certificate required by the Act of 1891?" (I think that question must have been meant and understood to mean, "Could you have given the certificate for 1891 required by the Act?") "(A) Yes, certainly. (Q) Then why did you not do so? (A) Because I was not aware that it was considered necessary for me to give the certificate either in the words of the Act or not at all." Mr. Theobald's interpretation of his own certificate cannot be received either in his favour or against him, and we should not unduly press against him apparent admissions made in the course of a very trying cross-examination. But this evidence of his does, I think, go so far as to show that the certificates were in fact given as reports under the Act, and independent of that evidence I think there can be no doubt that they were intended to be and were received and acted upon as reports under the Act.

I consider the giving of the certificates (assuming them to be to the knowledge of the auditors misleading certificates, a question which I shall deal with separately) to be a misfeasance within the meaning of section 10 of the Act of 1890, and not a mere act of negligence: and that this was a fair meaning of the charge contained in the summons I can have no doubt, having regard to the terms of the certificates given and the explanations of Mr. Theobald himself, that there was a strong and growing feeling of dissatisfaction in the mind of Mr. Theobald at the state of the affairs of the bank as shown by the books, and I find no sufficient communication of the facts causing this dissatisfaction in the reports. The Balance Sheets when examined do not in my opinion fulfil the statutory requirements of being full and fair Balance Sheets, and they are not properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company. To establish this, I think it necessary to give a short summary of the evidence, as to the years 1889, 1890, and 1891, the only years as to which we have sufficient evidence to be able to arrive at definite conclusions. From the tables set out at page 7 of the Official Receiver's report it appears that during the years 1889, 1890, and 1891 the greater part of the business of the bank consisted in making loans to and discounting bills for a group of companies, nine in number, conveniently referred to as the Balfour group, or the Balfour companies. Loans were also made or discounting facilities afforded to other companies allied to the Balfour companies, to certain directors of the bank, and customers, including Wilkinson and Benham, who are named in the table, by reason of special considerations affecting their accounts. These accounts of allied companies and the persons last mentioned are for convenience hereinafter referred to as "the special accounts."

The balance due from the Balfour companies at the end of the years 1889, 1890, and 1891 were, for 1889 £119,000, for 1890 £218,000, and for

1891 £308,000. Corresponding balances in the "special accounts" were, for 1889 £77,000, for 1890 £112,000, for 1891 £121,000, the aggregate balances from the Balfour companies and on the special accounts being for 1889 £196,000, for 1890 £321,000, for 1891 £429,000. The corresponding balances due from all other customers and persons were, for 1889, £135,000, for 1890 £103,000, for 1891 £100,000. Roughly speaking, the proportion of what may be called the outside business to that with the Balfour companies and on the special accounts was, at the end of 1889 two-thirds, at the end of 1890 one-third, and at the end of 1891 one-fourth. The paid-up capital increased in 1890 by about £76,000, and in 1891 by about £43,000, or altogether £120,000, but the whole of this and considerably more than £100,000 in addition had been absorbed into the accounts of the Balfour companies and the special accounts.

It has already been pointed out that the amount of cash and easily realisable securities at the end of 1891 was hardly more than one-sixth of the amount due to customers on current accounts, or about one-half of what Mr. Theobald had in 1886 pointed out to be required according to the usual practice of bankers.

These figures show an alarming absorption during the three years of the available assets of the company in advances to the Balfour companies and on the special accounts, and a perilous diminution of easily realisable assets. As is usual with banking companies, profits alleged to have been earned by the bank consisted with unsubstantial exceptions of interest on loans, discounting of bills, and commissions.

The gross profits entered in the books as having been earned from the Balfour companies, between the incorporation of the bank and the end of 1891, amounted to upwards of £84,000. The amount distributed in dividends during the same period was upwards of £58,000, and the amount carried to reserve fund, £13,000. I include there £3,000 carried to reserve fund in accordance with the report on the accounts of 1891, making together £71,000.

The reserve fund, however, was not required by the articles of association to be kept separate, and was not kept separate from the general funds of the bank. It was employed in the bank's business, quite rightly, no doubt.

Subject to an argument as to appropriation of payments dealt with hereafter, the profits supposed to have been earned from the Balfour companies were not actually paid, but they were only debited in the accounts current of the different companies, and, speaking generally, the moneys owing by the different companies went on increasing from year to year. It is evident that, unless these profits could be fairly

treated as not only earned but payable within a reasonable time, there would at the end of 1891 be no profits out of which a dividend could be paid, but, on the contrary, a large deficiency.

The learned Judge, after a careful consideration and investigation of the evidence before him, has found as a fact, that the credits of these companies at the end of each year were generally credits created temporarily for the purpose of audit, and that such credits, in the majority of cases, were created either by the discounting of bills of companies like Hobbs & Co., which bills constituted a mere paper asset, or by loans direct or indirect from the bank itself, the bulk of which were ill-secured.

I see no reason to differ from this conclusion, but it is a conclusion arrived at to an important extent from comparing the books of the bank with the books of other companies of the Balfour group to which the auditors had no access, and it is only to the extent to which it is founded on entries in the books of the bank itself that it can be used for the purpose of charging the appellant with knowledge of the facts, though it is very important on the question whether the dividends were really paid out of capital or not. The books themselves show that in many instances the accounts were put in credit in the manner described by the learned Judge, but in other cases, and especially with reference to the indirect loans, that is to say, loans made by the bank to one of the companies out of which that company made an advance to another of the group for the purpose of putting the accounts of the latter in credit at the end of the year, the auditors would have no sufficient means of tracing the transactions.

Having made these general observations I will go on to examine more completely the important case of the accounts for the year 1891. For that purpose, as being more fair to the auditors, I will assume without at all deciding that, down to the end of 1890, no knowledge that the former Balance Sheets were misleading has been brought home to the auditors, and will endeavour to ascertain what additional information the auditors acquired during the audit for 1891. In the year 1891 the indebtedness of the Balfour companies to the bank as appearing by the bank books was increased by the sum of between £89,000 and £90,000 without any additional securities of importance being given, though, no doubt, to a considerable but unascertained extent money was expended on buildings already charged to the bank, which would make the property charged, though not necessarily the charges in favour of the bank, more valuable.

The securities consisted in the main of charges on buildings being constructed under building agreements, on which large sums had already been charged in priority to the bank. The buildings were unfinished, and required further expenditure of very large sums before

they could advantageously be disposed of, and in my judgment there was abundant evidence to show that these securities of the bank were very insufficient, and not realisable at all without the expenditure of further money, which the bank was unable to advance. The sums due on the special accounts had increased from £102,000 to £121,000, that is to say, between £18,000 and £19,000. With regard to these special accounts, I do not think it necessary to go in detail through the list, but I find that the auditors comment very unfavourably on the security for the following debts:—That of William Blewitt for £7,849; that of Blewitt and Balfour for £2,148; and that of Balfour for £12,000. I think, however, that they may have considered the personal security in these cases sufficient, and I do not found anything on those cases. Wilkinson, at the end of 1890, was indebted to the bank in the sum of £24,000, practically unsecured. Mr. Theobald complained about interest being debited, on the ground that the directors had then more definite information as to the security. This was going through the audit for 1890. The fact is that the security consisted of debentures of a tramway company whose tramway was never built. Interest accordingly ceased to be debited to this account in March 1891. When Mr. Theobald was pressed to explain why the full sum was returned as an asset, he replied that it would have to be provided for out of the reserve fund. He further explained that he thought the account wanted watching, but that it was likely to turn out all right. In examination before the Judge with reference to this debt, he said that he had conferred with the manager, who knew all about the circumstances. "First of all," says he, "I suggested the whole should be written off, but afterwards, Mr. Brock, I think it was, sent for Mr. Blewitt. We had a very serious conference about it, and they convinced me that the time had not come to do that (write off the whole), and they might yet get the whole of the amount back, but I thought it was not wise to charge interest."

This, I think, falls very far indeed short of showing that the auditor believed, or could have believed, that the debt was a good debt, though it might have justified the carrying of it to a Suspense Account, instead of writing it off as bad. The importance of the case depends upon the fact that if the debt had not been entered in the Balance Sheet as a good debt, there would have been no profit at all to show for the year 1891. At the end of 1891, Mr. Wilkinson's debt, which had arisen from discounting bills, all of which would appear by the dates to have been dishonoured, was reduced to £16,000 on account of discount by a loan of £10,000, but the indebtedness remained unaffected. With regard to Benham's debt, which increased in the year 1891 from £31,635 to £47,745, it was proved that in 1891 Mr. Theobald refused to pass the security for another year, and to satisfy him, a letter purporting to

come from Benham's solicitor, Mr. Waring, containing an undertaking to pay off £15,000 within a week, was produced. He had also been told, during the audit for 1890, that there was a security under a supposed will which had not been proved, and that they expected to get the will proved very soon. During the audit for 1891, he ascertained that the debt had increased from £31,000 to £47,000, that the £15,000 promised to be repaid had not been repaid, and that the alleged will had not been proved—indeed, it turned out afterwards that such a will never existed. The explanation of Mr. Theobald, that he trusted to the solicitor seeing that the security was all right, is not, under the circumstances, altogether satisfactory, but I think it is safer to allow Mr. Theobald the benefit of the defence, though his own report sufficiently shows that he was not himself thoroughly satisfied. I wish to make it plain, so far as I can, that I am only relying on matters which Mr. Theobald ought to have known and must be presumed to have known. The debt of £7,300 from the Medway Portland Cement Company had, like Wilkinson's, ceased to be charged with interest, and could not properly have been treated as a fund for the payment of dividend. With reference to that of the Public Works Company, Lim., amounting to £8,105, the auditors, in their schedule to their report to the directors, say this—"The realisation of this is very doubtful." There could, therefore, be no justification for treating this as a fund for payment of dividend. Whilst Mr. Theobald was engaged upon the audit of the accounts for 1891, or previously, a report of Messrs. Balfour and Brock, dated 22nd of December 1891, was produced to him as to the way of putting into credit current accounts of Hobbs & Co., Lim., George Newman & Co., Lim., the London, Edinburgh, and Glasgow Insurance Co., and C. H. Wilkinson, by loans from the bank. With reference to Mr. Wilkinson's account, the proposal "that the overdraft should be made in part by a loan and in part by fresh acceptances of both secured as may be arranged, we think the further loan should be £10,000 on loan and £15,000 on bills." The loan was made, and, apparently, £16,000 was left on security of acceptances, but it does not appear that any security was then arranged for or given, or that Mr. Theobald investigated this matter. Attention was, therefore, called in this particular case to the mode in which the accounts were put in credit as found by the learned Judge. Several facts which appear to me to be most material with reference to the debt of 1891 are to be gathered from the text of the report. I have dealt, to a certain extent, with the schedule in the remarks I have previously made, but as to the text of the report of the auditors of February 1892, almost every sentence is full of serious meaning. In it they state "that they are unable to give a more satisfactory certificate than the one set forth," which is a mere statement that the Balance Sheet is a correct summary of the accounts as recorded in the books, followed by a statement that the

value of the assets as shown on the Balance Sheet is dependent upon realisation, which I have already commented upon, an important sentence: "On this subject we have reported specifically to the board." This may mean they have reported as to the value of the assets, or as to their realisation, or (as I think is the true construction) as to both. The auditors were induced to withdraw this sentence, which, though it would have given no information of the slightest value to the members, yet would have been calculated to put them upon inquiry. They go on:—"We are not qualified, nor is it the province of the auditors, to estimate with exactitude the value of the securities." The words "with exactitude" seem to me to be emphatic, and to point out that they had, as appears by the report, made a general estimate of the securities which was very unfavourable. They say:—"Nevertheless, we feel it our duty to send you herewith a schedule of the securities amounting to £487,000, which we desire should have the special and very serious consideration of the directors."

In the £487,000 are included every one of the sums owing by the Balfour companies and on the special accounts, and nearly £60,000 more out of the £100,000 owing by other customers of the bank. Auditors who feel it their duty to call the special and very serious consideration of their directors to £487,000 out of a total of £530,000 of the debts due to the bank must indeed have arrived at the opinion that the state of affairs of the company was critical and dangerous, but as will appear Mr. Theobald does not deny this, though he attempts, unsuccessfully I think, to explain it away by saying that all his anxiety arose from the fact of the assets being locked up. Further on in the report the auditors say "The gravity of the situation is enhanced by the fact as we believe it to be that the board is in many cases powerless to decline further help because they are powerless to realise." This appears to me to be a very just but a very serious statement. The Balfour companies were indeed so much bound up with one another by a system of inter-financing, and some of them had committed themselves so deeply in the building schemes of Hobbs & Co., Newman & Co., and others, that they would only be kept going in the future as they had been in the past by continued advances from the funds of the bank. The last quoted extract from the report seems to me to show that the auditors fully appreciated this view of the state of affairs of the company. They continue as follows:—"We beg also respectfully to point out that the quarters from which the bank obtains by far the larger proportion of its business"—meaning, I conclude, the Balfour companies, and some of the special accounts—"are such that the constitution of the board must make it difficult, if not impossible, to obtain a sufficiently independent judgment upon many vital questions which have to be decided in its management." No doubt this

refers to the fact that some members of the board of the bank, the financing company, were members also of the board of different Balfour companies requiring advances, and the difficulty arising from this is obvious and serious. Then follows a sentence which forms an appropriate ending to such a report: "We cannot conclude without expressing the opinion unhesitatingly that no dividend should be paid this year." The auditors were, unfortunately, persuaded by Mr. Balfour, assisted by Mr. Brock, to strike out this clause, I believe before the report reached the hands of the other directors of the bank. Mr. Theobald explains this by saying that he came to the conclusion that it was beyond the province of the auditors to express an opinion as to the policy of declaring a dividend, and if that were all I should be disposed to agree with him. It is no part of the auditor's duty to consider what is good or what is bad policy. They have only to examine into facts and see that the members have their opinion as to the Balance Sheet showing the state of affairs of the company. But the context seems to oblige me to read the excised sentence as meaning not that it was impolitic, but that it would be improper, having regard to the state or affairs of the company, to declare a dividend. Having regard to the explanations given by Mr. Theobald in his evidence, I think the postscript to this report very significant. It runs thus: "We do not wish it to be understood that we consider all the accounts in the schedule are unsecured, but as a whole the capital therein represented is locked up." That is the defence, that all their alarm arose from the capital being locked up. This is not, I think, the language that would have been used if the auditors had thought that the only mischief was in the locking up, and an examination of the schedule to my mind confirms this conclusion. To a great extent the memoranda in the schedule explain themselves, and I have already dealt with many of the items. The accounts of each one of the Balfour companies is referred to in such a way as to show the unsatisfactory state of the securities. Mr. Theobald now says that he had no doubt as to the solvency of any of the Balfour companies, and in a certain sense I am ready to believe this; that is to say, he thought that if they continued to be financed in the future as they had been in the past, and so were enabled to complete the buildings which had been commenced, they might ultimately be able to repay the advances to them with interest and commission. But this is not the meaning of solvency in a legal or business sense, and it is quite plain that Mr. Theobald knew perfectly well that some at least of these companies were, and were likely to remain for an indefinite period, unable to meet their liabilities as they became due. In no other way can the memoranda as to the want of security, or the defective nature of the securities, of the several Balfour companies be explained. Similar observations apply to the memoranda as to the special accounts. Notwithstanding

this report, every item of the £487,000 was entered as a good debt in the Balance Sheet for 1891. No valuation was made of any one of the debts, or of the securities for them. If any such valuation had, in fact, been made, I think it plain that there could have been no profit shown for the year. Mr. Theobald gave evidence several times over to the effect that whilst he was engaged in the audit for 1891 he felt that it was a very important crisis in the bank's affairs, and that if they could only get over the next month or so they would save it. His explanation of his withdrawal of the words in the proposed report to the members is that on this point he had reported specifically to the board. In explanation he gave among other carefully prepared and considered reasons the following: That "Mr. Balfour was so thoroughly aroused to the necessity for taking the affairs of the bank resolutely in hand as to lead me to believe that he would do so, and, being a man of great financial resource, he would be able to save the bank"; and that Mr. Balfour also spoke of an amalgamation. "Mr. Balfour said that, while doing this, he would confer with me continuously, and that no interim dividend should be paid without consultation with me." The first intimation received of payment of the interim dividend was an announcement in the Press of an interim dividend for 1892, for which it is not suggested Mr. Theobald was in any way liable. This would have given twelve months to work, during which time it would have been quite possible for Mr. Balfour to obtain very large repayments from the borrowing companies with which he was connected, and thus for the bank to be saved. That is a very important point to make.

In another place he says, "My main point is this, that the bank could be saved if many of these accounts were collected. Mr. Balfour had absolute power over most of these companies, and he was so thoroughly alarmed that I quite believed that if we could only tide over that period he would use his influence over other companies to bring the money into the bank. I quite imagined he would do that, even if it meant that some of the other companies would have to go to the wall." What becomes of his statement that he thought the companies were solvent? He says it is a critical time; if you can tide over the next month or two—as to which he never expresses an opinion—if you can do that, then the resources of Mr. Balfour are so great, his influence with the other companies so great, that it is quite possible he may collect a number of the accounts, even if the other companies have got to go to the wall. I think it is impossible to avoid the conclusion that Mr. Theobald, when about to make his report on the accounts of 1891, was thoroughly alarmed at the critical position of the bank, as he thought it more than likely the bank would not tide over another month or two, but that if it did, it could only be saved by extraordinary exertions on Mr. Balfour's part, and that in the process some of the other

Balfour companies might have to go to the wall. He represents Mr. Balfour as fully sharing his alarm. If we turn to the Balance Sheet to see whether the state of the company's affairs, as apprehended by Mr. Theobald, was in any way indicated therein, we shall, I think, be obliged to answer the question in the negative.

The liabilities appear to be sufficiently set forth. It is the statement of the assets which most calls for criticism. The cash at the bank was correctly stated, and so are the bills receivable, though the amount of £180,000 there appears only to have been arrived at by transferring £58,000 on December 31 1891 from bills receivable to a loan account for unpaid expenses. Disregarding the small item for stamps, the only other items on the credit side are as follows:—"Investments, including reserve fund"—the reserve fund at that time was £10,000—"2¾ per cent. Consols and Prescott and Arizona Railway bonds, £7,820." That could not be the investments which included the reserve fund of £10,000. "Loans to customers and other securities, £346,000." In the two items, bills receivable and loans to customers and other securities, are, as above pointed out, included the whole of the sums, amounting to £487,000, the subject of the report of the auditors to the directors, at their full value. This item, loans to customers and other securities, is, of course, altogether inaccurate and may be very misleading. What the £346,000 really consists of is "loans to customers partly secured," which is a very different matter. It would be open to any ordinary reader of the Balance Sheet to suppose that there were securities to an indefinite amount apart from loans to customers, and available to meet moneys due on the current accounts of customers. I am at a loss to understand for what purpose this item could have been so entered. It was not through inadvertence, for it was a correction of a still more misleading entry occurring in former Balance Sheets. It was suggested that such an item frequently appears in Balance Sheets. It may be so for anything I know, but it is none the less improper in the particular Balance Sheet which we have to consider. In short, the Balance Sheet, as it stands, would have given no hint to any ordinary reader of the critical position arising either from the locking-up of capital or from the doubtful nature of many of the debts entered at their full value. In reporting this Balance Sheet without explanation, the auditors were, in my judgment, guilty of a misfeasance within the meaning of the 10th section of the Act of 1890, as charged in the summons, and were in this case, at any rate, thoroughly alive to the unsatisfactory state of the affairs of the bank. They could not but be aware that the Balance Sheet was not properly drawn up so as to show the state of the affairs of the bank as shown by the books. The next question is whether the misfeasance was the cause of loss to the company. On examination of the evidence there set forth, I should be led

to the conclusion that the auditors did know that a dividend could not properly be paid out of profits.

See how the figures stand from another point of view. The Profit and Loss Account shows a gross profit of £24,000. After making provision for bad and doubtful debts, and after deduction of £6,600 for expenses of management and other charges, there is carried over to the Balance Sheet a net profit of £18,000 odd, out of which there had already been applied £6,000 and more in payment of an interim dividend, leaving a balance of between £11,000 and £12,000 and nothing more. £3,000 of that was to be carried to reserve; so you have only about between £8,000 and £9,000, according to the books, for dividend. But of the gross profits for the year 1891 shown by the books, £16,788 were book entries debited to the Balfour companies, £2,462 a book entry debited to Benham's account, and £275 a book entry debited to Wilkinson's account. That, of course, was in the early part of the year, Wilkinson's account being treated as a debit. Assuming all the Balfour companies, and Benham and Wilkinson, to have been able to pay the whole sums due from them, except the amounts debited in 1891 for interest and commission, not only the profits available for dividend would be swept away, but of the reserve fund itself little or nothing would be left. Such an assumption, however, in my judgment, would have been extravagantly favourable to the auditors, and it only required that one of the debts owing by Mr. Wilkinson (I leave out Benham because I do not want to found on Benham any charge against Mr. Theobald), or almost any one of the Balfour companies should turn out to be bad, it would exhaust everything belonging to the bank which was not capital. It turned out that each of the Balfour companies, as well as Wilkinson and Benham, as well as other debtors of the bank, were insolvent. In my judgment it is established that the bank had no funds out of which the dividends could in any point of view be properly paid. I think the auditors might well be held to have known, but I do not rely upon that conclusion in my judgment; what I do rely upon is that the auditors must have known and did know that the Balance Sheet was not properly drawn up so as to show the state of affairs, and that was a misfeasance. If they were guilty of misfeasance in relation to the company, they must be responsible for the consequences of such misfeasance, whether they had arrived at the conclusion that the dividend if paid at all would be payable out of capital or not. That dividends were, in fact, paid out of capital cannot, I think, be doubted. It was argued that before the stoppage of the bank the profits entered in the 1891 Balance Sheet were, in fact, paid by appropriation of moneys paid into current accounts. This would not apply to a case like Wilkinson, where there was no current account, but in my judgment the rule in *Clayton's* case has no sort of application under the circumstances. If it had, a bank might always pay profits by mere book

entries, though the customers against whom interest and commission were charged might all be hopelessly insolvent. Was, then, the loss occasioned by the misfeasance of the auditors? It has been argued that the payment of the dividend was not the proximate result of the auditors' report, as the recommendation of the directors and the vote of the meeting had to intervene. This appears to me to misrepresent the true state of things. The report of the auditors was a continuing representation, made indeed before, but in law and in good sense to be treated as repeated after, the recommendation of the directors. It was perfectly well known to Mr. Theobald (at any rate at the meeting where he was present and heard the reading of the report recommending a dividend, and the speech of Mr. Balfour) that this report was intended to be relied upon as justifying the recommendation and as an invitation to vote the dividend. How far the judgment should go against the appellant has given me considerable difficulty. A great deal of the reasoning which has led me to hold that their reporting on the accounts of 1891 is a misfeasance in relation to the company applies only to the case of that report. The learned Judge has held Mr. Theobald liable not only for the 1891, but also for the 1890, dividend. I am far from saying that he is clearly wrong, but I cannot satisfy myself that he is clearly right. In the case of the 1890 dividend it cannot, on the evidence, be made out to my full satisfaction that the auditors knew the Balance Sheet to be substantially misleading, and I think it safer to confine the order to the dividend in respect of 1891.

Lord Justice Lindley : The order will stand as to one dividend with interest, but not as to the other.

The case of THE METROPOLITAN COAL CONSUMERS'
ASSOCIATION, LIM. *v.* J. & A. SCRIMGEOUR.

(Decided before Lords Justices LINDLEY, LOPES, and RIGBY, in the
Court of Appeal, on July 16 1895.)

Company—Issue of Shares—Brokers' Commission.

Appeal from a decision of a Divisional Court (Justices Day and Wright), which affirmed a decision of the Recorder of London.

The action was brought by the company, now in liquidation, to recover back commissions paid to a firm of stockbrokers in respect of shares of the company placed by the defendants.

The facts were that the directors, having decided to make an issue of shares, passed a resolution that a commission of 2½ per cent. should be allowed to brokers through whom applicants were obtained. The defendants received from the company prospectuses and forms of application,

stamped the forms with their name, and supplied them to their customers. They afterwards claimed and were paid the 2½ per cent. commission on shares applied for on forms stamped by them.

The memorandum of association purported to authorise the payment of commission for placing shares.

No profits were ever made by the company.

The Recorder and the Divisional Court held that the commission could not be recovered back, and that the action failed.

The company appealed.

JUDGMENT.

Their Lordships held that a reasonable commission to brokers for their services in procuring applicants for shares could properly be paid out of capital, whether authorised by the memorandum or not, and, without expressing any opinion that the money could have been recovered back had the payment been *ultra vires*, dismissed the appeal.

The case of THE KINGSTON COTTON MILL COMPANY, LIM.

(Decided before Lord HERSCHELL and Lords Justices A. L. SMITH and RIGBY, in the Court of Appeal, on November 22 1895.)

Auditors as officers of a Company.

This was an appeal from a decision of Mr. Justice Vaughan Williams, reported in 12 *The Times* L.R. p. 21. A misfeasance summons having been taken out by the Official Receiver in the winding-up of the above-named company against the directors and auditors, the auditors applied for a stay of proceedings as against them on the ground that they were not officers of the company within section 10 of the Companies (Winding-up) Act 1890. The articles of the above-named company with reference to the audit of the accounts were in substance in the same terms as the audit clauses of Table A to the Companies Act 1862, which, it will be remembered, any limited company other than a banking company is at liberty either to adopt or reject. In the recent case of *In re The London and General Bank, Lim.* (11 *The Times* L.R. 374) it was decided by the Court of Appeal that an auditor of a banking company regulated by the Companies Act 1879, which made it compulsory on every banking company within the Act to appoint an auditor, was an officer of the company within the meaning of section 10 of the Act of 1890. The articles of the London and General Bank contained clauses relating to the audit of accounts, which substantially embodied the provisions of the Act of 1879, and which

did not materially differ from the articles of the present company except that the articles of the present company nowhere in terms referred to the auditors as officers of the company. Mr. Justice Vaughan Williams held that the auditors were officers of the company within the meaning of section 10 of the Act of 1890. The auditors appealed.

Mr. Swinfen Eady, Q.C., and Mr. Eve, Q.C., in support of the appeal, contended that the ordinary professional relationship between a professional man and a company did not constitute him an officer of the company within the meaning of the misfeasance section of the Act of 1890. That section was confined to persons carrying on the business of the company and having the control of the assets. The word "misfeasance" in the Act of 1890 referred to an act in the nature of a breach of trust, and was not applicable to the responsibility of an auditor who had been guilty of negligence in the audit of the accounts. It had been held that neither a banker nor a broker nor a solicitor was an officer of the company. There was no obligation on a company, other than a banking company, to employ an auditor at all, and an auditor was not a person in the continuous employment of the company, but was appointed annually to perform a single duty.

Mr. Cozens Hardy, Q.C., and Mr. W. D. Rawlins, for the Official Receiver, contended that this case was not distinguishable from the case of *In re The London and General Bank, Lim.*

Mr. Eve, Q.C., replied.

JUDGMENT.

Lord Herschell: In this case an application is made under the 10th section of the Companies (Winding-up) Act 1890 to proceed against the directors and the auditors of the company on the ground that they have been guilty respectively of misfeasance within the meaning of that section. We have not here to determine whether they have been guilty of such misfeasance. We have not the facts before us. We have not even to determine whether the allegations of the summons show a *prima facie* case of what would be misfeasance under the statute. All that we have to determine is whether the auditors in the present case are persons in a position and coming within the meaning of the word "officers" under the 10th section, so as to entitle the liquidator to proceed against them. Now, a question very similar to this came before the Court of Appeal in the case of *In re The London and General Bank*. The question there was whether the auditors of the London and General Bank were officers within the meaning of the section in question. This Court held that they were, and I can see no substantial distinction between that case and the present. I will allude in a moment to the distinctions which have been suggested, but it seems to me that it would

be frittering away the case altogether if we were to rest our determination upon any of the distinctions which alone can be made in the present case. Now, I desire to express no opinion upon the question whether *In re The London and General Bank* was rightly or wrongly decided. It may be that the reasoning in that case is open to criticism. It may be that some considerations which bear upon the question were not referred to, or had not full effect given to them; on all that I express no opinion at all. I desire to retain absolute liberty of action, in case it should hereafter become necessary, on the question whether *In re The London and General Bank* was rightly decided. Now let us see what *In re The London and General Bank* did decide. It decided that the auditors appointed in that case were officers within the meaning of the section. On what grounds? Under the Act of 1879 certain articles contained in Table A to the Act of 1862, which prior to that Act companies might either adopt or reject as they pleased, became by statute absolutely binding on banking companies. That, even if not strictly accurate, is sufficiently accurate for the purpose of this case. They had to appoint auditors, and certain provisions were made applicable to them, which were in substance the provisions of Table A so far as auditors are concerned. Now, the London and General Bank, besides these, what I may call compulsory articles, had also articles of its own. The reasoning in that case was rested largely, I may say mainly, on this—that the auditors were by the provisions of the Act of 1879, which were made applicable to the bank, made officers of the company. The language of those provisions was dwelt upon as showing that they were officers of the company. It is true, and here comes the distinction suggested, that in that case they were so denominated in an indemnity clause, whereas in the present case they are not so denominated. But it would be far too narrow a distinction to rest any difference of decision on that ground. Therefore, in the present case the articles are in substance the same, the auditors are created officers, if they are officers in that case, in precisely the same way as in the present case. I can see no substantial distinction between the two. If misfeasance of officers extended to the auditors in the case of the London and General Bank, it seems to me that no substantial reason can be given why misfeasance of officers should not extend to auditors in the present case. I cannot in substance distinguish the two cases. But, of course, all that we decide is that, in a case identical with *In re The London and General Bank*, as I take this to be in substance, the auditor is an officer. We decide that as bound by the previous decision of the Court of Appeal. Beyond that our decision does not go. I say this in consequence of some general observations made by the learned Judge in the Court below, as to which I express no opinion. For these reasons I think that this appeal must be dismissed.

A. L. Smith, L.J., and Rigby, L.J., concurred.

The case of THE KINGSTON COTTON MILL COMPANY, LIM.

(Decided before Lords Justices LINDLEY, LOPES, and KAY, in the Court of Appeal, on May 19 1896.)

Liability of Auditors for Dividends Improperly Paid—Dividends out of Capital—Valuation of Stock—Duties of Auditors—Companies (Winding-up) Act 1890, s. 10.

This was an appeal by Messrs. Benjamin Pickering and Arthur Edgar Peasegood, the former auditors of the company, now in liquidation, against an order of Mr. Justice Vaughan Williams under section 10 of the Companies (Winding-up) Act 1890, making them liable to make good to the assets of the company moneys of the company improperly applied in payment of dividends on the faith of certain Balance Sheets certified by them. The facts in the case were fully reported in Vol. XII., *Accountant Law Reports*, p. 225.

Mr. Haldane, Q.C., Mr. Swinfen Eady, Q.C., and Mr. T. A. Watson were for the auditors; Mr. Cozens-Hardy, Q.C., Mr. Rawlins, Q.C., and Mr. Marshall Hall were for the Official Receiver and liquidator.

The appeal was argued on May 6, 7, and 8.

Their Lordships now delivered judgment, allowing the appeal.

Lord Justice Lindley said:—This is an appeal from an order made by Mr. Justice Vaughan Williams under section 10 of the Companies (Winding-up) Act 1890, on Mr. Pickering and Mr. Peasegood, the auditors of the company, ordering them to pay to the liquidator certain sums of money, being the amounts of dividends improperly declared and paid out of the assets of the company on the faith of certain Balance Sheets prepared and signed by the auditors. The appeal is based upon two grounds—(1) that the auditors have not failed to discharge their duty to the company and are under no liability to make good the money misapplied; (2) that, even if they have, the proper remedy is by action and not by the summary process to which the liquidator has had recourse. It will be convenient to dispose of the second point first. It has already been decided that the auditors of this company are “officers” within the meaning of section 10 of the Companies (Winding-up) Act 1890 (see 1896, 1 Ch. 6; *The Times Law Reports*, Vol. XII., p. 60). The object of that section is the same as that of section 165 of the Companies Act 1862, which it has replaced. That object was to facilitate the recovery by the liquidator of assets of a company improperly dealt with by its promoters, directors, or other officers. The section applies to breaches of trust and misfeasances by such persons. I agree that the section does not apply to all cases in which actions by the company will lie for the recovery of damages against the persons

named ; it is easy to imagine cases of breach of contract, trespasses, negligences, or other wrongs to which the section is inapplicable, and some such have been the subject of judicial decision ; but I am not aware of any authority to the effect that the section does not apply to the case of an officer who has committed a breach of his duty to the company, the direct consequence of which has been a misapplication of its assets, for which he could be made responsible by an action at law or in equity. Such a breach of duty, if established, is a "misfeasance" within the meaning of the section, or, to adopt the language used in *Cavendish-Bentinck v. Fenn* (12 A.C. 652), such a breach of duty is a misfeasance in the nature of a breach of trust. This view of the section was adopted by this Court in *In re The London and General Bank* (1895, 2 Ch. 166, 673 ; *The Times* Law Reports, Vol. XI., pp. 374, 573), and is, in my opinion, correct. On this preliminary point, therefore, which, however, does not touch the merits of the case, the appellants are not entitled to succeed. I come now to the real question in this controversy, and that is, whether the appellants have been guilty of any breach of duty to the company. To decide this question it is necessary to consider (1) What their duty was ; (2) How they performed it, and in what respects (if any) they failed to perform it. The duty of an auditor generally was very carefully considered by this Court in *In re The London and General Bank* (1895, 2 Ch. 673), and I cannot usefully add anything to what will be found on pages 682-84. It was there pointed out that an auditor's duty is to examine the books, ascertain that they are right, and to prepare a Balance Sheet showing the true financial position of the company at the time to which the Balance Sheet refers. But it was also pointed out that an auditor is not an insurer, and that in the discharge of his duty he is only bound to exercise a reasonable amount of care and skill. It was further pointed out that what in any particular case is a reasonable amount of care and skill depends on the circumstances of that case ; that if there is nothing which ought to excite suspicion, less care may properly be considered reasonable than could be so considered if suspicion was or ought to have been aroused. These are the general principles which have to be applied to cases of this description. I protest, however, against the notion that an auditor is bound to be suspicious, as distinguished from being reasonably careful. To substitute the one expression for the other may easily lead to serious error. I pass now to consider the complaint made against the auditors in this particular case. The complaint is that they failed to detect certain frauds. There is no charge of dishonesty on the part of the auditors. They did not certify or pass anything which they did not honestly believe to be true. It is said, however, that they were culpably careless. The circumstances are as follows : For several years frauds were committed by the manager, who, in order to bolster up the company and make it appear flourishing when

it was the reverse, deliberately exaggerated both the quantities and values of the cotton and yarn in the company's mills. He did this at the ends of the years 1890, 1891, 1892, and 1893. There was no book or account (except the Stock Journal, to which I will refer presently) showing the quantity or value of the cotton or yarn in the mill at any one time. It would not be easy to keep such a book. Nor is it wanted for ordinary purposes. There is considerable waste (20 or 25 per cent. on the average) in the manufacture of yarn from cotton, and the market prices of both cotton and yarn are subject to great fluctuations. The Balance Sheets of each year contained on the asset side entries of the values of the stock-in-trade at the end of the year, and those entries were stated to be "as per manager's certificate." There were also in the Balance Sheets entries on the opposite side of the values of the stock-in-trade at the beginning of the year. The quantities did not appear in either case. The auditors took the entry of the stock-in-trade at the beginning of the year from the last preceding Balance Sheet, and they took the values of the stock-in-trade at the end of the year from the Stock Journal. The book contained a series of accounts under various heads purporting to show the quantities and values of the company's stock-in-trade at the end of each year, and a summary of all the accounts showing the total value of such stock-in-trade. The summary was signed by the manager, and the value as shown by it was adopted by the auditors and was inserted as an asset in the Balance Sheet, but "as per manager's certificate." The summary always corresponded with the accounts summarised, and the auditors ascertained that this was the case. But they did not examine further into the accuracy of the accounts summarised. The auditors did not profess to guarantee the correctness of this item. They assumed no responsibility for it. They took the item from the manager, and the entry in the Balance Sheet showed that they did so. I confess I cannot see that their omission to check his returns was a breach of their duty to the company. It is no part of an auditor's duty to take stock. No one contends that it is. He must rely on other people for details of the stock-in-trade in hand. In the case of a cotton mill he must rely on some skilled person for the materials necessary to enable him to enter the stock-in-trade at its proper value in the Balance Sheet. In this case the auditors relied on the manager. He was a man of high character and of unquestioned competence. He was trusted by everyone who knew him. The learned Judge has held that the directors are not to be blamed for trusting him. The auditors had no suspicion that he was not to be trusted to give accurate information as to the stock-in-trade in hand, and they trusted him accordingly in that matter. But it is said they ought not to have done so, and for this reason. The Stock Journal showed the quantities—that is, the weight in pounds—of the cotton and yarn at the end of each year. Other books showed the quantities of cotton bought during

the year and the quantities of yarn sold during the year. If these books had been compared by the auditors they would have found that the quantity of cotton and yarn in hand at the end of the year ought to be much less than the quantity shown in the Stock Journal, and so much less that the value of the cotton and yarn entered in the Stock Journal could not be right, or, at all events, was so abnormally large, as to excite suspicion and demand further inquiry. This is the view taken by the learned Judge. But, although it is no doubt true that such a process might have been gone through, and that, if gone through, the fraud would have been discovered, can it be truly said that the auditors were wanting in reasonable care in not thinking it necessary to test the managing director's returns? I cannot bring myself to think they were, nor do I think that any jury of business men would take a different view. It is not sufficient to say that the frauds must have been detected if the entries in the books had been put together in a way which never occurred to anyone before suspicion was aroused. The question is whether, no suspicion of anything wrong being entertained, there was a want of reasonable care on the part of the auditors in relying on the returns made by a competent and trusted expert relating to matters on which information from such a person was essential. I cannot think there was. The manager had no apparent conflict between his interest and his duty. His position was not similar to that of a cashier who has to account for the cash which he receives, and whose own account of his receipts and payments could not reasonably be taken by an auditor without further inquiry. The auditor's duty is not so onerous as the learned Judge has held it to be. The order appealed from must be discharged with costs.

Lopes, L.J., in the course of his judgment, made the following observations upon the duties of auditors:—It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care, and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious and careful. His Lordship then referred to the circumstances which led to the auditors being deceived, and came to the conclusion that they were not wanting in skill, care, or caution, in accepting the figures

of the manager, and he concluded as follows:—The duties of auditors must not be rendered too onerous. Their work is responsible and laborious, and the remuneration moderate. I should be sorry to see the liability of auditors extended any further than in *In re The London and General Bank*. Indeed, I only assented to that decision on account of the inconsistency of the statement made to the directors with the Balance Sheet certified by the auditors and presented to the shareholders. This satisfied my mind that the auditors deliberately concealed that from the shareholders which they had communicated to the directors. It would be difficult to say this was not a breach of duty. Auditors must not be made liable for not tracking out ingenious and carefully-laid schemes of fraud, when there is nothing to arouse their suspicion and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable.

Kay, L.J., concurred.

The case of SALOMON (Pauper) *v.* A. SALOMON & CO., LIM.

(Decided before the LORD CHANCELLOR and Lords WATSON, HERSHELL, MACNAGHTEN, MORRIS, and DAVEY, in the House of Lords, on November 16 1896.)

Company—Winding-up—Sale of Business to "Private Company"—One-man Company—Debentures issued to Founder—Indemnity—Rescission.

This was an appeal from a decision of the Court of Appeal dismissing an appeal from a judgment by Mr. Justice Vaughan Williams. The appellant, Aron Salomon, for about thirty years prior to 1892, carried on business as a leather merchant and hide factor and wholesale and export boot manufacturer, under the style of A. Salomon & Co. According to the evidence of the appellant and his son, the profits of the business were between £1,000 and £2,000 per annum. A limited company was formed in 1892 to carry on the business, and the original subscribers to the memorandum of association were the appellant, his wife, and daughter, and his four sons, who each signed for one share. The appellant's business was sold to the company for £38,782, of which £16,000 was to be paid in cash or debentures, and at the first meeting of the directors, who consisted of the appellant and two of his sons, it was resolved to pay the appellant £6,000 in cash and £10,000 in debentures. These debentures were afterwards mortgaged by the appellant to one Edmund Broderip as a security for an advance of £5,000, but eventually these debentures were cancelled and £10,000 fresh

debentures were issued to Edmund Broderip. In October 1893 an order was made for the winding-up of the company, at which date the company was indebted to unsecured creditors other than Aron Salomon to the amount of £7,733, the business of the company showing a loss of £2,600 a year. An action was brought by the liquidator of the company against the appellant, which was tried before Mr. Justice Vaughan Williams, who declared that the company were entitled to be indemnified by the appellant to the amount of £7,733. This decision was affirmed by the Court of Appeal. The appellant now sought to have the latter judgment reversed. The case was argued some time ago, when judgment was reserved.

JUDGMENT.

Their Lordships, on the 16th inst., delivered judgment, reversing the decision of the Court below.

The Lord Chancellor: The important question in this case, which I am not certain is the only question, is whether the respondent company was a company at all: whether, in truth, that artificial creation of the Legislature had been validly constituted in this instance; and, in order to determine that question, it is necessary to look at what the statute itself has determined in that respect. I have no right to add to the requirements of the statute, nor to take from the requirements thus enacted. The sole guide must be the statute itself. Now, that there were seven actual living persons who held shares in the company has not been doubted. As to the proportionate amounts held by each I will deal presently; but it is important to observe that this first condition of the statute is satisfied, and it follows as a consequence that it would not be competent to anyone, and certainly not to these persons themselves, to deny that they were shareholders. I must pause here to point out that the statute enacts nothing as to the extent or degree of interest which may be held by each of the seven, or as to the proportion of interest or influence possessed by one or the majority of the shareholders over the others. One share is enough. Still less is it possible to contend that the motive of becoming shareholders or of making them shareholders is a field of inquiry which the statute itself recognises as legitimate. If they are shareholders they are shareholders for all purposes, and, even if the statute was silent as to the recognition of trusts, I should be prepared to hold that if six of them were the *cestui que trusts* of the seventh, whatever might be their rights *inter se*, the statute would have made them shareholders to all intents and purposes with their respective rights and liabilities; and dealing with them in their relation to the company, the only relations which I believe the law would sanction would be that they were corporators of the corporate body. I am simply here dealing with the provisions of the statute, and it seems to

me to be essential to the artificial creation that the law should recognise only that artificial existence, quite apart from the motives or conduct of individual corporators. In saying this I do not at all mean to suggest that if it could be established that this provision of the statute to which I am adverting had not been complied with, you could not go behind the certificate of incorporation to show that a fraud had been committed upon the officer intrusted with the duty of giving the certificate, and that by some proceeding in the nature of *scire facias* you could not prove the fact that the company had no real legal existence. But short of such proof it seems to me impossible to dispute that once the company is legally incorporated, it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are. I will, for the sake of argument, assume the proposition that the Court of Appeal lays down, that the formation of the company was a mere scheme to enable Aron Salomon to carry on business in the name of the company. I am wholly unable to follow the proposition that this was contrary to the true intent and meaning of the Companies Act. I can only find the true intent and meaning of the Act from the Act itself, and the Act appears to me to give a company a legal existence with, as I have said, rights and liabilities of its own, whatever may have been the ideas or schemes of those who brought it into existence. I observe that the learned Judge (Mr. Justice Vaughan Williams) held that the business was Mr. Salomon's business and no one else's, and that he chose to employ as agent a limited company. And he proceeded to argue that he was employing that limited company as agent, and that he was bound to indemnify that agent—the company. I confess it seems to me that that very learned Judge becomes involved by this argument in a very singular contradiction. Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not. Lord Justice Lindley, on the other hand, affirms that there were seven members of the company, but, he says, it is manifest that six of them were members simply in order to enable the seventh himself to carry on business with limited liability. The object of the whole arrangement is to do the very thing which the Legislature intended not to be done. It is obvious to inquire where is that intention of the Legislature manifested in the statute? Even if we were at liberty to insert words to manifest that intention I should have great difficulty in ascertaining what the exact intention thus imputed to the Legislature is or was. In this particular case it is the members of one family that represent all the shares; but if the supposed intention is not limited to so narrow a proposition as this, that

the seven members must not be members of one family, to what extent may influence or authority or intentional purchase of a majority among the shareholders be carried so as to bring it within the supposed prohibition? It is, of course, easy to say that it was contrary to the intention of the Legislature—a proposition which, by reason of its generality, it is difficult to bring to the test; but when one seeks to put as an affirmative proposition what the thing is which the Legislature has prohibited, there is, as it appears to me, an insuperable difficulty in the way of those who seek to insert by construction such a prohibition into the statute. As one mode of testing the proposition it would be pertinent to ask whether two or three, or, indeed, all seven, may constitute the whole of the shareholders. Whether they must be all independent of each other in the sense of each having an independent beneficial interest—and this is a question that cannot be answered by the reply that it is a matter of degree. If the Legislature intended to prohibit something, you ought to know what that something is. All it has said is that one share is sufficient to constitute a shareholder, though the shares may be 100,000 in number. Where am I to get from the statute itself a limitation of that provision that that shareholder must be an independent and beneficially interested person? I find all through the judgment of the Court of Appeal a repetition of the same proposition to which I have already adverted—that the business was the business of Aron Salomon, and that the company is variously described as a myth and a fiction. Lord Justice Lopes says:—“The Act contemplated the incorporation of seven independent *bond fide* members, who had a mind and a will of their own, and were not the mere puppets of an individual who, adopting the machinery of the Act, carried on his old business in the same way as before, when he was a sole trader.” The words “seven independent *bond fide* members with a mind and will of their own and not the puppets of an individual” are by construction to be read into the Act. Lord Justice Lopes also said that the company was a mere *nominis umbra*. Lord Justice Kay said:—“The statutes were intended to allow seven or more persons *bond fide* associated for the purpose of trade to limit their liability under certain conditions, and to become a corporation. But they were not intended to legalise a pretended association for the purpose of enabling an individual to carry on his own business with limited liability in the name of a joint stock company.” The learned Judges appear to me not to have been absolutely certain in their own minds whether to treat the company as a real thing or not. If it was a real thing, if it had a legal existence, and if, consequently, the law attributed to it certain rights and liabilities in its constitution as a company, it appears to me to follow as a consequence that it is impossible to deny the validity of the transactions into which it has entered. Mr. Justice Vaughan Williams appears to me to have disposed of the argument that the company,

which for this purpose he assumed to be a legal entity, was defrauded into the purchase of Aron Salomon's business, because, assuming that the price paid for the business was an exorbitant one, as to which I am myself not satisfied, but assuming that it was, the learned Judge most cogently observes that when all the shareholders are perfectly cognisant of the conditions under which the company is formed and the conditions of the purchase, it is impossible to contend that the company is being defrauded. The proposition laid down in *Erlanger v. The New Sombrero Phosphate Company* (L.R. 3 Appeal Cases, 1,218)—I quote the head-note—is that "Persons who purchase property and then create a company to purchase from them the property they possess, stand in a fiduciary position towards that company, and must faithfully state to the company the facts which apply to the property, and would influence the company in deciding on the reasonableness of acquiring it." But if every member of the company, every shareholder, knows exactly what is the true state of the facts, which for this purpose must be assumed to be the case here, Mr. Justice Vaughan Williams's conclusion seems to me to be inevitable—that no case of fraud upon the company could here be established. If there was no fraud and no agency, and if the company was a real one and not a fiction or a myth, every one of the grounds upon which it is sought to support the judgment is disposed of. The truth is that the learned Judges have never allowed in their own minds the proposition that the company has a real existence. They have been struck by what they have considered the inexpediency of permitting one man to be, in influence and authority, the whole company, and assuming that such a thing could not have been intended by the Legislature, they have sought various grounds upon which they might insert into the Act some prohibition of such a result. Whether such a result be right or wrong, politic or impolitic, I say, with the utmost deference to the learned Judges, that we have nothing to do with that question if this company has been duly constituted by law, and, whatever may be the motives of those who constitute it, I must decline to insert into that Act of Parliament limitations which are not to be found there. I have dealt with this matter upon the narrow hypothesis propounded by the learned Judges below, but it is, I think, only justice to the appellant to say that I see nothing whatever to justify the imputations which are implied in some of the observations made by more than one of the learned Judges. The appellant, in my opinion, is not shown to have done, or to have intended to do, anything dishonest or unworthy, but to have suffered a great misfortune without any fault of his own. The result is that I move your Lordships that the judgment appealed from be reversed, but as this is a pauper case I regret to say it can only be with such costs in this House as are appropriate to that condition of things, and that this appeal be dismissed with costs to the same extent.

Lord Watson : This appeal raises some questions of practical importance, depending upon the construction of the Companies Acts, which do not appear to have been settled by previous decisions. As I am not prepared to accept without reservation all the conclusions of fact which found favour with the Courts below, I shall, before adverting to the law, state what I conceive to be the material facts established by the evidence before us. The appellant, Aron Salomon, for many years carried on business, on his own account, as a leather merchant and wholesale boot manufacturer. With the design of transferring his business to a joint stock company, which was to consist exclusively of himself and members of his own family, he, on July 20 1892, entered into a preliminary agreement with one Adolph Anholt, as trustee for the future company, settling the terms upon which the transfer was to be made by him, one of its conditions being that, in part payment, he was to receive £10,000 in debentures of the company. A memorandum of association was then executed by the appellant, his wife, a daughter, and four sons, each of them subscribing for one share, in which the leading object for which the company was formed was stated to be the adoption and carrying into effect, with such modifications (if any) as might be agreed on, of the provisional agreement of July 20. The memorandum was registered on July 28 1892; and the effect of registration, if otherwise valid, was to incorporate the company, under the name of "Aron Salomon & Company, Lim.," with liability limited by shares, and having a nominal capital of £40,000 divided into 40,000 shares of £1 each. The company adopted the agreement of July 20, subject to certain modifications which are not material; and an agreement to that effect was executed between them and the appellant on August 2 1892. Within a month or two after that date the whole stipulations of the agreement were fulfilled by both parties. In terms thereof, 100 debentures, for £100 each, were issued to the appellant, who, upon the security of these documents, obtained an advance of £5,000 from Edmund Broderip. In February 1893 the original debentures were returned to the company and cancelled; and in lieu thereof, with the consent of the appellant as beneficial owner, fresh debentures to the same amount were issued to Mr. Broderip, in order to secure the repayment of his loan, with interest at 8 per cent. In September 1892 the appellant applied for and obtained an allotment of 20,000 shares; and from that date until an order was made for its compulsory liquidation, the share register of the company remained unaltered, 20,001 shares being held by the appellant, and six shares by his wife and family. It was all along the intention of these persons to retain the business in their own hands, and not to permit any outsider to acquire an interest in it. Default having been made in the payment of interest upon his debentures, Mr. Broderip, in September 1893, instituted an action in order to enforce his security against the assets of the company.

Thereafter a liquidation order was made, and a liquidator appointed, at the instance of unsecured creditors of the company. It has now been ascertained that, if the amount realised from the assets of the company were, in the first place, applied in extinction of Mr. Broderip's debt and interest, there would remain a balance of about £1,055, which is claimed by the applicant as beneficial owner of the debentures. In the event of his claim being sustained there will be no funds left for payment of the unsecured creditors, whose debts amount to £7,733 8s. 6d. The liquidator lodged a defence, in name of the company, to the debenture suit, in which he counterclaimed against the appellant (1) to have the agreements of July 20 and August 2 1892 rescinded, (2) to have the debentures already mentioned delivered up and cancelled, (3) repayment of all sums paid by the company to the appellant under these agreements, and (4) a lien for these sums upon the business and assets. The averments made in support of these claims were to the effect that the price paid by the company exceeded the real value of the business and assets by upwards of £8,200; that the arrangements made by the appellant for the formation of the company were a fraud upon the creditors of the company; that no board of directors of the company was ever appointed, and that in any case such board consisted entirely of the appellant, and there never was an independent board. The case went to proof before Mr. Justice Vaughan Williams, when the liquidator was examined as a witness on behalf of the company, whilst evidence was given for the appellant by himself and by his son, Emanuel Salomon, one of the members of the company, who had been employed in the business for nearly twenty years. The evidence shows that before its transfer to the new company the business had been prosperous, and had yielded to the appellant annual profits sufficient to maintain himself and family and to add to his capital. It also shows that at the date of transfer the business was perfectly solvent. The liquidator, whose testimony was chiefly directed toward proving that the price paid by the company was excessive, admitted on cross-examination that the business when transferred to the company was in a sound condition, and that there was a substantial surplus. No evidence was led tending to support the allegation that no board of directors was ever appointed or that the board consisted entirely of the appellant. The non-success and ultimate insolvency of the business, after it came into the hands of the company, was attributed by the witness Emanuel Salomon to a succession of strikes in the boot trade, and there is not a tittle of evidence tending to modify or contradict his statement. I think it also appears from the evidence that all the members of the company were fully cognisant of the terms of the agreements of July 20 and August 2 1892, and that they were willing to accept and did accept these terms. The case was heard before the learned Judge who presided at the proof, who, at the close of the

argument, announced that he was not prepared to grant the relief craved by the company. He at the same time suggested that a different remedy might be open to the company, and on the motion of their counsel, he allowed the counterclaim to be amended. In conformity with the suggestion thus made by the Bench, a new and alternative claim was added for (1) a declaration that the appellant is liable to indemnify the company against the whole of their unsecured debts, (2) judgment against him for £7,733 8s. 3d., being the amount of these debts, and (3) a lien for that amount upon all sums which might be payable to the appellant by the company, in respect of his debentures or otherwise, until the judgment was satisfied. There were also added averments to the effect that the company was formed by the appellant and that the debentures for £10,000 were issued in order that he might carry on the business and take all the profits without risk to himself, and also that the company was the "mere nominee and agent" of the appellant. The allegations of the company, in so far as they have any relation to the amended claim, their pith consisting in the averments made on amendment, were meant to convey a charge of fraud, and it is unfortunate that they are framed in such loose and general terms. A relevant charge of fraud ought to disclose the specific facts necessitating the inference that a fraud was perpetrated upon some person specified. Whether it was a fraud upon the company and its members, or upon persons who had dealings with the company, is not indicated, although there may be very different considerations applicable to those two cases. The *res gesta* which might imply that it was the appellant, and not the company, who actually carried on its business, are not set forth. Any person who holds a preponderating share in the stock of a limited company has necessarily the intention of taking the lion's share of its profits, without any risk beyond loss of the money which he has paid for or is liable to pay upon his shares, and the fact of his acquiring and holding debentures secured upon the assets of the company does not diminish that risk. What is meant by the assertion that the company "was the mere nominee or agent" of the appellant I cannot gather from the record, and I am not sure that I understand precisely in what sense it was interpreted by the learned Judges whose decisions we have to consider. No additional proof was led after the amendment of the counterclaim. The oral testimony has very little, if any, bearing upon the second claim; and any material facts relating to the fraudulent objects which the appellant is said to have had in view, and the alleged position of the company as his nominee or agent, must be mere matter of inference derived from the agreements of July 20 and August 2 1892, the memorandum and articles of association, and the Minute Book of the company. On re-hearing the case Mr. Justice Vaughan Williams, without disposing of the original claim, gave the company decree of indemnity in terms of their amended claim. I do not profess my ability

to follow accurately the whole chain of reasoning by which the learned Judge arrived at that conclusion, but he appears to have proceeded mainly upon the ground that the appellant was in truth the company, the other members being either his trustees or mere "dummies," and consequently that the appellant carried on what was truly his own business under cover of the name of the company, which was nothing more than an *alias* for Aron Salomon. On appeal from his decision, the Court of Appeal, consisting of Lords Justices Lindley, Lopes, and Kay, made an order finding it unnecessary to deal with the original claim, and dismissing the appeal in so far as it related to the amended claim. The ratio upon which that affirmance proceeded, as embodied in the order, was, "This Court, being of opinion that the formation of the company, the agreement of August 1892, and the issue of debentures to Aron Salomon pursuant to such agreement, were a mere scheme to enable him to carry on business in the name of the company, with limited liability, contrary to the intent and meaning of the Companies Act 1862, and, further, to enable him to obtain a preference over other creditors of the company by procuring a first charge on the assets of the company by means of such debentures." The opinions delivered by the Lords Justices are strictly in keeping with the reasons assigned in their order. Lord Justice Lindley, after observing "that the incorporation of the company cannot be disputed," refers to the scheme for the formation of the company, and says (1895, 2 Ch.D. 377), "the object of the whole arrangement is to do the very thing which the Legislature intended not to be done"; and he adds that "Mr. Salomon's scheme is a device to defraud creditors." Assuming that the company was well incorporated in terms of the Act of 1862, an assumption upon which the decisions appealed from appear to me to throw considerable doubt, I think it expedient, before considering the amended claim, to deal with the original claim for rescission, which was strongly pressed upon us by counsel for the company, under their cross appeal. Upon that branch of the case there does not appear to me to be much room for doubt. With this exception, that the word "exorbitant" appears to me to be too strong an epithet, I entirely agree with Mr. Justice Vaughan Williams when he says, "I do not think that when you have a private company, and all the shareholders in the company are perfectly cognisant of the conditions under which the company is formed, and the conditions of the purchase by the company, you can possibly say that purchasing at an exorbitant price (and I have no doubt whatever that the purchase here was at an exorbitant price) is a fraud upon those shareholders or upon the company." The learned Judge goes on to say that the circumstances might have amounted to fraud if there had been an intention on the part of the original shareholders "to allot further shares at a later period to future allottees." Upon that point I do not find it necessary to express any opinion; because it is not raised

by the facts of the case, and, in any view, these considerations are of no relevancy in a question as to rescission between the company and the appellant. Mr. Farwell argued that the agreement of August 2 ought to be set aside, upon the principle followed by this House in *Erlanger v. New Sombrero Phosphate Company, Lim* (3 Appeal Cases). In that case the vendor, who got up the company, with the view of selling his adventure to it, attracted shareholders by a prospectus which was essentially false. The directors, who were virtually his nominees, purchased from him without being aware of the real facts; and on their assurance that, in so far as they knew, all was right, the shareholders sanctioned the transaction. The fraud by which the company and its shareholders had been misled was directly traceable to the vendor; and it was set aside at the instance of the liquidator, the Lord Chancellor (Earl Cairns) expressing a doubt whether, even in those circumstances, the remedy was not too late, after a liquidation order. But in this case the agreement of July 20 was, in the full knowledge of the facts, approved and adopted by the company itself, if there was a company, and by all the shareholders who ever were or were likely to be members of the company. In my opinion, therefore, *Erlanger v. New Sombrero Phosphate Company* has no application, and the original claim of the liquidator is not maintainable. The Lords Justices of Appeal, in disposing of the amended claim, have expressly found that the formation of the company, with limited liability, and the issue of £10,000 worth of its debentures to the appellant, were "contrary to the true intent and meaning of the Companies Act 1862." I have had great difficulty in endeavouring to interpret that finding. I am unable to comprehend how a company, which has been formed contrary to the true intent and meaning of a statute, and (in the language of Lord Justice Lindley) does the very thing which the Legislature intended not to be done, can yet be held to have been legally incorporated in terms of the statute. "Intention of the Legislature" is a common but very slippery phrase, which, popularly understood, may signify anything from intention embodied in positive enactment to speculative opinion as to what the Legislature probably would have meant, although there has been an omission to enact it. In a Court of law or equity, what the Legislature intended to be done or not to be done can only be legitimately ascertained from that which it has chosen to enact, either in express words or by reasonable and necessary implication. Accordingly, if the words "intent and meaning," as they occur in the finding of the Appeal Court, are used in their proper legal sense, it follows, in my opinion, that the company has not been well incorporated; that, there being no legal corporation, there can be no liquidation under the Companies Acts, and that the counterclaim preferred by its liquidator must fail. In that case its creditors would not be left without a remedy, because its members, as joint traders without limitation of their liability,

would be jointly and severally responsible for the debts incurred by them in the name of the company. I can conceive that there might be a limited company formed and registered by a person who had the sole interest in it, the other subscribing members being persons who were his *aliases*, and having no real existence ; and in that case also (which does not occur here) there would be no legal company, and the real owner of the concern would be liable for its debts to the full extent of his means. The provisions of the Act of 1862 which seem to me to have any bearing upon this point lie within a very narrow compass. Section 6 provides that any seven or more persons, associated for a lawful purpose, such as the manufacture and sale of boots, may, by subscribing their names to a memorandum of association and otherwise complying with the provisions of the Act in respect of registration, form a company with or without limited liability ; and section 8, which prescribes the essentials of the memorandum in the case of a company limited by shares, *inter alia*, enacts that "no subscriber shall take less than one share." The first of these enactments does not require that the persons subscribing shall not be related to each other, and the second plainly imports that the holding of a single share affords a sufficient qualification for membership ; and I can find no other rule laid down or even suggested in the Act. Nor does the statute, either expressly or by implication, impose any limit upon the number of shares which a single member may subscribe for or take by allotment. At the date of registration all the requirements of the Act had been complied with ; and, as matters then stood, there does not appear to have been any room for the pleas now advanced by the liquidator. The company was still free to modify or reject the agreement of July 20 ; and the fraud of which the appellant has been held guilty by the Court of Appeal, though it may have existed *in animo*, had not been carried into execution by the acceptance of the agreement, the issue of debentures to the appellant in terms of it, and by his receiving an allotment of shares which increased his interest in the company to ~~20000~~ of its actual capital. I have already intimated my opinion that the acceptance of the agreement is binding on the company : and neither that acceptance, nor the preponderating share of the appellant, nor his payment in debentures, being forbidden by the Act, I do not think that any one of these things could subsequently render the registration of the company invalid. But I am willing to assume that proceedings which are permitted by the Act may be so used by the members of a limited company as to constitute a fraud upon others, to whom they in consequence incur personal liability. In this case the fraud is found to have been committed by the appellant against the creditors of the company, but it is clear that, if so, though he may have been its originator and the only person who took benefit from it, he could not have done any one of those things which, taken together, are said to constitute his fraud without the

consent and privity of the other shareholders. It seems doubtful whether a liquidator, as representing and in the name of the company, can sue its members for redress against a fraud which was committed by the company itself and by all its shareholders. However, I do not think it necessary to dwell upon that point, because I am not satisfied that the charge of fraud against creditors has any foundation in fact. The memorandum of association gave notice that the main object for which the company was formed was to adopt and carry into effect, with or without modifications, the agreement of July 20 1892, in terms of which the debentures for £10,000 were subsequently given to the appellant in part payment of the price. By the articles of association—article 62 (e)—the directors were empowered to issue mortgage or other debentures or bonds for any debts due or to become due to the company; and it is not alleged or proved that there was any failure to comply with section 43 or the other clauses of Part III. of the Act, which relate to the protection of creditors. The unpaid creditors of the company, whose unfortunate position has been attributed to the fraud of the appellant, if they had thought fit to avail themselves of the means of protecting their interests which the Act provides, could have informed themselves of the terms of purchase by the company, of the issue of debentures to the appellant, and of the amount of shares held by each member. In my opinion, the statute casts upon them the duty of making inquiry in regard to these matters. Whatever may be the moral duty of a limited company and its shareholders, when the trade of the company is not thriving, the law does not lay any obligation upon them to warn those members of the public who deal with them on credit that they run the risk of not being paid. One of the learned Judges asserts, and I see no reason to question the accuracy of his statement, that creditors never think of examining the register of debentures. But the apathy of a creditor cannot justify an imputation of fraud against a limited company or its members, who have provided all the means of information which the Act of 1862 requires. And, in my opinion, a creditor who will not take the trouble to use the means which the statute provides for enabling him to protect himself must bear the consequence of his own negligence. For these reasons I have come to the conclusion that the orders appealed from ought to be reversed, with costs to the appellant here and in both Courts below. His costs in this House must, of course, be taxed in accordance with the rule applicable to pauper litigants.

Lord Herschell: By an order of the High Court, which was affirmed by the Court of Appeal, it was declared that the respondent company, or the liquidator of that company, was entitled to be indemnified by the appellant against the sum of £7,733 8s. 3d., and it was ordered that the respondent company should recover that sum against the appellant. On

July 28 1892 the respondent company was incorporated with a capital of £40,000, divided into 40,000 shares of £1 each. One of the objects for which the company was incorporated was to carry out an agreement, with such modifications therein as might be agreed to, of July 20 1892, which had been entered into between the appellant and a trustee for a company intended to be formed for the acquisition by the company of the business then carried on by the appellant. The company was, in fact, formed for the purpose of taking over the appellant's business of leather merchant and boot manufacturer, which he had carried on for many years. The business had been a prosperous one, and as the learned Judge who tried the action found, was solvent at the time when the company was incorporated. The memorandum of association of the company was subscribed by the appellant, his wife, and daughter, and his four sons, each subscribing for one share. The appellant afterwards had 20,000 shares allotted to him. For these he paid £1 per share out of the purchase-money which, by agreement, he was to receive for the transfer of his business to the company. The company afterwards became insolvent and went into liquidation. In an action brought by a debenture-holder on behalf of himself and all the other debenture-holders, including the appellant, the respondent company set up, by way of counterclaim, that the company was formed by Aron Salomon, and the debentures were issued in order that he might carry on the said business and take all the profits without risk to himself, that the company was the mere nominee and agent of Aron Salomon, and that the company or the liquidator thereof was entitled to be indemnified by Aron Salomon against all the debts owing by the company to creditors other than Aron Salomon. This counterclaim was not in the pleading as originally delivered; it was inserted by way of amendment at the suggestion of Vaughan Williams, J., before whom the action came on for trial. The learned Judge thought the liquidator entitled to the relief asked for, and made the order complained of. He was of opinion that the company was only an *alias* for Salomon; that the intention being that he should take the profits without running the risk of the debts, the company was merely an agent for him, and having incurred liabilities at his instance, was, like any other agent under such circumstances, entitled to be indemnified by him against them. On appeal the judgment of Vaughan Williams, J., was affirmed by the Court of Appeal, that Court "being of opinion that the formation of the company, the agreement of August 1892, and the issue of debentures to Aron Salomon pursuant to such agreement, were a mere scheme to enable him to carry on business in the name of the company, with limited liability, contrary to the true intent and meaning of the Companies Act 1862, and further, to enable him to obtain a preference over other creditors of the company, by procuring a first charge on the assets of the company by means of such debentures." The learned

Judges in the Court of Appeal dissented from the view taken by Vaughan Williams, J., that the company was to be regarded as the agent of the appellant. They considered the relation between them to be that of trustee and *cestui que trust*, but this difference of view, of course, did not affect the conclusion that the right to the indemnity claimed had been established. It is to be observed that both Courts treated the company as a legal entity distinct from Salomon and the then members who composed it, and therefore as a validly-constituted corporation. This is, indeed, necessarily involved in the judgment which declared that the company was entitled to certain rights as against Salomon. Under these circumstances, I am at a loss to understand what is meant by saying that A. Salomon & Company, Lim., is but an *alias* for A. Salomon. It is not another name for the same person: the company is *ex hypothesi* a distinct legal *persona*. As little am I able to adopt the view that the company was the agent of Salomon to carry on his business for him. In a popular sense, a company may in every case be said to carry on business for and on behalf of its shareholders, but this certainly does not in point of law constitute the relation of principal and agent between them, or render the shareholders liable to indemnify the company against the debt which it incurs. Here, it is true, Salomon owned all the shares except six, so that if the business were profitable he would be entitled, substantially, to the whole of the profits. The other shareholders, too, are said to have been "dummies," the nominees of Salomon. But when once it is conceded that they were individual members of the company distinct from Salomon, and sufficiently so to bring into existence in conjunction with him a validly constituted corporation, I am unable to see how the facts to which I have just referred can affect the legal position of the company, or give it rights as against its members which it would not otherwise possess. The Court of Appeal based their judgment on the proposition that the formation of the company, and all that followed it, were a mere scheme to enable the appellant to carry on business in the name of the company, with limited liability, contrary to the true intent and meaning of the Companies Act 1862. The conclusion which they drew from this premise was that the company was a trustee and Salomon their *cestui que trust*. I cannot think that the conclusion follows, even if the premise be sound. It seems to me that the logical result would be that the company had not been validly constituted, and, therefore, had no legal existence. But, apart from this, it is necessary to examine the proposition on which the Court have rested their judgment, as its effect would be far-reaching. Many industrial and banking concerns of the highest standing and credit have, in recent years, been, to use a common expression, converted into joint stock companies, and often into what are called "private" companies, where the whole of the shares are held by the former partners. It appears to me that all these might

be pronounced "schemes to enable" them "to carry on business in the name of the company, with limited liability," in the very sense in which those words are used in the judgment of the Court of Appeal. The profits of the concern carried on by the company will go to the persons whose business it was before the transfer, and in the same proportions as before, the only difference being that the liability of those who take the profits will no longer be unlimited. The very object of the creation of the company, and the transfer to it of the business, is that, whereas the liability of the partners for debts incurred was without limit, the liability of the members for the debts incurred by the company shall be limited. In no other respect is it intended that there shall be any difference; the conduct of the business and the division of the profits are intended to be the same as before. If the judgment of the Court of Appeal be pushed to its logical conclusion, all these companies must, I think, be held to be trustees for the partners who transferred the business to them, and those partners must be declared liable, without limit, to discharge the debts of the company. For this is the effect of the judgment as regards the respondent company. The position of the members of a company is just the same whether they are declared liable to pay the debts incurred by the company, or by way of indemnity to furnish the company with the means of paying them. I do not think the learned Judges in the Court below have contemplated the application of their judgment to such cases as I have been considering, but I can see no solid distinction between those cases and the present one. It is said that the respondent company is a "one-man" company, and that in this respect it differs from such companies as those to which I have alluded. But it has often happened that a business transferred to a joint stock company has been the property of three or four persons only, and that the other subscribers of the memorandum have been clerks or other persons who possess little or no interest only in the concern. I am unable to see how it can be lawful for three or four or six persons to form a company for the purpose of employing their capital in trading, with the benefit of limited liability, and not for one person to do so, provided, in each case, the requirements of the statute have been complied with, and the company has been validly constituted. How does it concern the creditor whether the capital of the company is owned by seven persons in equal shares, with the right to an equal share of the profits, or whether it is almost entirely owned by one person who practically takes the whole of the profits? The creditor has notice that he is dealing with a company the liability of the members of which is limited, and the register of shareholders informs him how the shares are held, and that they are substantially in the hands of one person, if this be the fact. The creditors in the present case gave credit to and contracted with a limited company: the effect of the decision is to give them the benefit, as regards one of the shareholders, of unlimited

liability. I have said that the liability of persons carrying on business can only be limited, provided the requirements of the statute be complied with, and this leads naturally to the inquiry, what are those requirements? The Court of Appeal has declared that the formation of the respondent company, and the agreement to take over the business of the appellant, were a scheme "contrary to the true intent and meaning of the Companies Act." I know of no means of ascertaining what is the intent and meaning of the Companies Act except by examining its provisions and finding what regulations it has imposed as a condition of trading with limited liability. The memorandum must state the amount of the capital of the company and the number of shares into which it is divided, and no subscriber is to take less than one share. The shares may, however, be of as small a nominal value as those who form the company please; the statute prescribes no *minimum*, and though there must be seven shareholders, it is enough if each of them holds one share, however small its denomination. The Legislature, therefore, clearly sanctions a scheme by which all the shares, except six, are owned by a single individual, and these six are of a value little more than nominal. It was said that in the present case the six shareholders other than the appellant were mere dummies, his nominees, and held their shares in trust for him. I will assume that this was so. In my opinion it makes no difference. The statute forbids the entry in the register of any trust, and it certainly contains no enactment that each of the seven persons subscribing the memorandum must be beneficially entitled to the share or shares for which he subscribes. The persons who subscribe the memorandum or have agreed to become members of the company, and whose names are on the register, are alone regarded as, and in fact are, the shareholders. They are subject to all the liability which attaches to the holding of the share; they can be compelled to make any payment which the ownership of a share involves. Whether they are beneficial owners or bare trustees is a matter with which neither the company nor creditors have anything to do. It concerns only them and their *cestuis que trustent*, if they have any. If, then, in the present case all the requirements of the statute were complied with, and a company was effectually constituted, and this is the hypothesis of the judgment appealed from, what warrant is there for saying that what was done was contrary to the true intent and meaning of the Companies Act? It may be that a company constituted like that under consideration was not in the contemplation of the Legislature at the time when the Act authorising limited liability was passed; that, if what is possible under the enactments as they stand had been foreseen, a minimum sum would have been fixed as the least denomination of share permissible, and it would have been made a condition that each of the seven persons should have a substantial interest in the company. But we have to interpret the law, not to make it; and it must be

remembered that no one need trust a limited liability company unless he so please, and that before he does so he can ascertain, if he so please, what is the capital of the company, and how it is held. I have hitherto made no reference to the debentures which the appellant received in part payment of the purchase-money of the business which he transferred to the company. These are referred to in the judgment as part of the scheme which is pronounced contrary to the true intent and meaning of the Companies Act. But if apart from this the conclusion that the appellant is bound to indemnify the company against its debts cannot be sustained, I do not see how the circumstance that he received these debentures can avail the respondent company. The issue of debentures to the vendor of a business as part of the price is certainly open to great abuse, and has often worked grave mischief. It may well be that some check should be placed upon the practice, and that, at all events, ample notice to all who may have dealings with the company should be secured. But as the law at present stands there is certainly nothing unlawful in the creation of such debentures. For these reasons I have come to the conclusion that the appeal should be allowed. It was contended on behalf of the company that the agreement between them and the appellant ought, at all events, to be set aside on the ground of fraud. In my opinion no such case has been made out, and I do not think the respondent company are entitled to any such relief.

The other noble and learned Lords having concurred, the decision of the Court below was reversed.

The case of WRAGG & Co., LIM.

(Decided before Mr. Justice VAUGHAN WILLIAMS, in the Chancery Division, on November 30 1896.)

*Company—Winding-up—Issue of Paid-up Shares—Shares at a Discount
—Registered Contract—Consideration—Misfeasance—Contributories—
Companies Act 1867, s. 25—Companies Winding-up Act 1890, s. 10.*

This company was incorporated on January 9 1894. It was what is known as a "private company," formed to take over a business of cab proprietors and livery stable keepers which belonged to Mr. E. J. Wragg, Mr. J. Bean Martin, and others, and, to state it shortly, the vendors of the business became the shareholders of the new company. On January 10 1894 Wragg and Martin, as representing the vendors, entered into an agreement with the company for the sale to the latter of the business, plant, &c., for £46,300, to be paid as follows:—£7,000

in cash, £3,000 in first mortgage debentures, £6,300 in second mortgage debentures, £10,000 by the company taking over certain mortgage liabilities, and £20,000 (the balance) in fully-paid shares of £10 each. The consideration was by the agreement allocated as follows:—£6,000 for goodwill and trade marks, £12,000 for freeholds, £500 for leaseholds, £27,300 for coaches, horses, &c., £250 for contract rights, &c., and £250 for the rent of the property taken over. The agreement was filed with the Registrar of Joint Stock Companies before any shares were issued. The company was afterwards ordered to be wound up, and the Official Receiver and Liquidator took out a summons seeking to have the vendors declared liable in respect of about £11,000, the difference between the item of £27,300 and the figure at which the coaches, horses, &c., had from the beginning of the company been set down in the company's books, the main ground being that to the extent of this difference the consideration was "a sham *pro tanto*," and that the vendor's shares were issued at a discount to that extent.

JUDGMENT.

Vaughan Williams, J., in giving judgment, pointed out the inconvenience which resulted generally from joining in one summons a claim for misfeasance and a claim to have it declared that persons were liable as contributories, and also dealt with another objection taken to the form of the summons. His Lordship then held that, as no damage resulted from what had been done, the claim for misfeasance failed. Another argument, his Lordship said, was that there was no such contract as was required to satisfy section 25 of the Companies Act 1867, and he distinguished the present case from *Smith v. Brown* (L.R. 1896, A.C. 614). That case was decided in the Privy Council, but if it had the meaning which the Solicitor-General put on it, it would be inconsistent with the decision of the House of Lords in *Salomon v. A. Salomon & Co., Lim.*, so far as could be judged from *The Times* report of that case (*The Times* L.R. vol. 12, p. 46). It was said that the Judges who decided both cases were practically the same persons, but the two bodies, the Judicial Committee and the House of Lords, were distinct legal entities, and his Lordship, though bound by the decision of the House of Lords, was not, technically, bound by those of the Judicial Committee. There was a contract in this case duly registered, but *In re Eddystone Marine Insurance Company* (L.R. 1893, 3 Ch. 9) showed that the holder of shares issued without consideration must pay the face value of the shares though a contract had been filed. But the facts of this case fell short of those in the *Eddystone* case, where the absence of any consideration appeared on the face of the contract. The question now was whether there was a real contract, and a real consideration

as against shares, and the Court could go behind the contract and say the contract was a sham to the extent to which the parties knew the consideration was not a real one. But the liquidator must show a sufficient case to induce the Court to go behind the contract, and that had not been done in the present case. The real value of the item for coaches, horses, &c., was about £11,000 less than the amount stated in the agreement, but it was not shown what were the different interests of the vendors in the various properties sold, or why the consideration was allocated as it had been. For aught his Lordship knew, some of the other items might have been undervalued. It was not shown that any shares were issued as a gift or bonus, and the summons must be dismissed with costs.

This decision was upheld in the Court of Appeal on March 20 1897.

The case of THE WESTERN COUNTIES STEAM BAKERIES
AND MILLING COMPANY, LIM.

(Decided before LINDLEY, SMITH, and RIGBY, L.JJ., in the Court of Appeal, on March 11 1897.)

This was an appeal from a decision of Mr. Justice Stirling. The appellants, Messrs. Parsons & Robjnt, had been employed by the directors to prepare a Balance Sheet and audit accounts of the above company for the year 1889; one of their clerks did the actual work, and signed the name of the firm at the foot of the accounts, vouching for their accuracy. The liquidator, in the winding-up, sought to make the two partners in the firm liable in respect of dividends declared on the faith of these accounts, by summary process, under the misfeasances clause (s. 10) of the Companies Act 1890. Mr. Justice Stirling held that Messrs. Parsons & Robjnt was an "officer" of the company within the meaning of that section, and was liable. Mr. Parsons appealed.

Their Lordships allowed the appeal with costs.

JUDGMENT.

Lindley, L.J., read the following judgment:—The question raised by this appeal is whether Messrs. Parsons & Robjnt are liable to be proceeded against under that section as an "officer" of the company. To answer this question it is necessary to ascertain who Messrs. Parsons & Robjnt are, and what they have done. They were accountants employed by one of the directors to audit the accounts of the company and to prepare a Balance Sheet for the year 1889, to be laid before the share-

holders of the company at their annual general meeting. This they did; he and his partner signed, *per pro.*, a certificate at the bottom, worded, "We have carefully examined the accounts of the Western Counties Steam Bakeries and Milling Company, and find the same to be in accordance with the above Balance Sheet, which shows the correct financial position of the company." The accounts were, in fact, examined, and the Balance Sheet prepared by a clerk of the firm, and he signed the name of the firm at the bottom of the certificate; but no reliance was placed by the appellants upon this circumstance. They admitted their clerk's authority to act for them, and they admitted their own liability for what their clerk did. Messrs. Parsons & Robjent were paid £12 12s. for their services by a cheque of the company. Now, if section 10 of the Winding-up Act 1890 contained the word "auditor," it might well be that Messrs. Parsons & Robjent, having acted as they did, could not be heard to say that they were not auditors, and section 10 might well apply to them. But the word "auditor" is not in the section, and what has to be determined is whether Messrs. Parsons & Robjent are officers of the company, or have so acted that they cannot be heard to say that they were not. If all persons who did auditor's work for a company were officers of the company the case would be easy: but no decision has yet gone this length. An auditor may or may not be an officer of a company. So may anybody else—*e.g.*, a banker or solicitor. *Prima facie* such persons are not officers. To be an officer there must be an office, and an office imports a recognised position with rights and duties annexed to it, and it would be an abuse of words to call a person an officer who fills no position either *de jure* or *de facto*, but who happens to do some of the work which he would have to do if he were an officer in the proper sense of the word. Messrs. Parsons & Robjent performed the duties which an auditor would have had to perform; it appears to me that they were no more *de facto* than *de jure* an officer of the company. They were simply accountants, called in by the directors to do a piece of work, and they never were, and never pretended to be, or acted as if they were, anything else. In my opinion the decisions in the cases of *The London and General Bank* and *The Kingston Cotton Mills Company* decided two points only—viz., first, that auditors might be officers within section 10, a proposition which, in the first case, was very stoutly disputed; and, secondly, that the auditors in those cases were officers of the companies then in question; that is, that the persons there had within section 10 really filled the office of auditor in those cases respectively.

Smith, L.J.: If the appellants were officers of the company upon January 30 1890, when they certified the correctness of the company's Balance Sheet for the year 1889, they may be proceeded against by means of such summons, otherwise they cannot be. It has been held by this Court in the case of *In re Kingston Cotton Mills Company* (1896, 1 Ch.D. 6), following the case also in this Court of *In re London and General Bank* (1895, 2 Ch.D. 166), that where a company, having articles of association similar to those in the present case, has appointed a person to the office of auditor of the company

such person is an "officer" within the meaning of section 10 of the Companies (Winding-up) Act of 1890. It having thus been held that a person appointed by the company to the office of auditor of the company is an officer within the meaning of the section, we are now asked to take a step further and to hold that a person who has never been appointed to the office of auditor or to any other office in the company at all is nevertheless an officer of the company if he has performed work which an auditor if he had been appointed by the company to the office of auditor would have undertaken and performed. The first case which is relied upon is that of *Gibson v. Barton* (L.R. 10 Q.B. 329), where it was held that a man who performed the work of manager of a company became thereby the *de facto* manager. The learned Judges held that "manager" in the 1862 Act meant manager *de facto*, and that a person who performed manager's work becomes thereby manager; but how does this establish that a person who performs auditor's work becomes an officer of the company? I agree that performing the work of an auditor shows the person to be a *de facto* though he may not be a *de jure* auditor, but to succeed the liquidator must show that the person is a *de facto* "officer." Some auditors are officers of a company and some are not. Those who are officers are within the section, not those who are not officers. It is no good ~~saying~~ ^{stating} that a person performs auditor's work; it must be shown that he is a *de facto* officer of the company. The next case is that of *Coventry and Dixon's* case (14 Ch.D. 660). There two directors did the work of directors without being qualified to be directors. Sir George Jessel held ~~them~~ to be *de facto* directors though they were not *de jure* directors, and as such were liable to be proceeded against summarily by way of a misfeasance summons. When this case was under appeal (it was reversed upon another point) Lord Justice Bramwell said if he (that is, the director) has done anything wrong as a *de facto* director no doubt he can be got at under the clause. In this I agree, and if Messrs. Parsons & Robjert had done anything wrong as *de facto* officers they could be got at; but they have done nothing of the sort, for the simple reason they have never become officers of the company at all. I agree that doing the work of a director may make a person a *de facto* director, and the section enacts that a director may be proceeded against by summons. Doing the work of a manager may make a person a *de facto* manager, and the section enacts that a manager may be proceeded against by summons. So in the case of a liquidator. Doing the work of an auditor may make a person a *de facto* auditor, but the section does not make an auditor liable to be proceeded against; it is only when he is *de facto* or *de jure* an officer of the company that he can be proceeded against by summons under section 10. In this case Messrs Parsons & Robjert were neither *de facto* nor *de jure* officers of the company; then how can they be said with truth to be officers of the company? All that this Court has heretofore held is that an auditor may be proceeded against by summons if he is *de facto* an officer of the company. It has not held that a man may be proceeded against by summons when he is neither *de facto* nor *de jure* an officer of the company. The question is

not, were the applicants *de facto* auditors? It is, were they *de facto* officers?

Rigby, L.J., concurred.

The case of BLOOMENTHAL (*Appellant*) v. FORD (LIQUIDATOR OF VEUVE MONNIER ET SES FILS, LIM.) (*Respondent*).

(Decided before Lord HALSBURY, L.C., Lords HERSCHELL, MACNAGHTEN, MORRIS, and SHAND, in the House of Lords, on February 23 1897.)

Company—Winding-up—Contributory—Shares Certified as Fully Paid-up—Allottee for Value—Misrepresentation—Estoppel.

Where a man lends money to a company, and, by way of collateral security, accepts shares on the certificate of which it is stated that each of them is fully paid up, the liquidator, in winding-up, is estopped from setting up the untruth of the allegation on the faith of which the money was advanced, and the lender is entitled to have his name removed from the list of contributories; and it is no answer to the lender's claim that he might by inquiry or reflection have discovered that in fact nothing had been paid on the shares.

JUDGMENT.

Their Lordships reversed the decision of the Court of Appeal, 65 L.J. Rep. Ch. 748; L.R. (1896) 2 Ch. 525.

The case of CITIZENS' AUDITOR v. THE CITY COUNCIL, MANCHESTER CORPORATION.

(Decided before Mr. Justices CAVE and LAWRENCE, in the Queen's Bench Division, on March 18 1897.)

Inspection of Minutes of Town Council and Committees—Municipal Corporations Act 1882, s. 233.

The action brought by Mr. Norbury Williams, one of the citizens' auditors, and Mr. Edward Woodall against the Manchester Corporation, to determine the extent of the right given by section 233 of the Municipal Corporations Act to a burgess of a borough to inspect the minutes of the Council and its Committees, came on for hearing in the Queen's Bench Division on March 18. Cave and Lawrence, JJ., sat as a Divisional Court to try special cases. Mr. C. A. Russell, Q.C. (instructed by Messrs. Hinde, Milne & Bury, Manchester), appeared for the plaintiffs, and the Corporation were represented by Mr. Asquith, Q.C., M.P., and Mr. M'Morran, Q.C. (instructed by the Town Clerk, Mr. W. H. Talbot). Amongst the gentlemen present in Court were Mr.

Norbury Williams, Mr. Talbot, Aldermen Gibson and Higginbottom (chairman and deputy-chairman of the Gas Committee), and Mr. Charles Nickson (superintendent of the Gas Department of the Corporation).

In the statement of the case it was set forth that : The plaintiffs are citizens of the city of Manchester, which has a population of upwards of 529,000, and of which the number of enrolled citizens is 87,627. The defendants are a municipal corporation regulated by the Municipal Corporations Act 1882, which provides as follows by section 233 :—" The minutes of proceedings of the Council shall be open to the inspection of a burgess on the payment of a fee of one shilling, and a burgess may make a copy thereof or take an extract therefrom. A burgess may make a copy of, or take an extract from, an order of the Council for the payment of money." Certain standing orders for the management of the business of the Council were made by the Manchester Council. Among them were the following :—" X. (1) No motion or amendment shall be made or proposed or any discussion allowed upon the confirmation of the proceedings of the several Committees with reference to any matter within the province of a Committee which does not appear upon the minutes to be confirmed ; but any member may put a question to the chairman of the Committee with reference to any such matter." " XI. (1) An epitome of minutes of the several Committees of the Council shall be prepared each month under the direction of the town clerk and be submitted to the chairman of each Committee prior to its being sent to the Council." The Council have appointed no fewer than twenty-one Committees, and the ordinary business of the Corporation is regulated and managed by them. The minutes kept by the Council merely refer to the proceedings of the Committees by stating that the proceedings of each Committee have been approved. Minutes of the proceedings of Committees are also recorded in books, which are submitted for the approval of the Council. The acts or proceedings of the Committee which are approved by the Council are not specifically recorded in the minutes of the Council, but are approved by reference to the minutes of the several Committees, and can be ascertained only by inspection of such minutes. The plaintiffs made an application for an inspection of the minutes of the proceedings of the Gas and Rivers Committees, which are referred to in the minutes of the Council as having been read and approved during the past two years, and they tendered the fees mentioned in the section. They were not allowed to see them, but were referred to the Council minutes. The Corporation objected to produce the Minute Books so kept by the Gas Committee and Rivers Committee respectively, on the ground that the production of the minutes of the Committees would be inimical to the interests of the citizens of Manchester. The Corporation, having regard to the foregoing considerations, were of

opinion that it was not consistent with the public interests to permit inspection of the minutes of the Committee in all cases ; and, as they were advised that such inspection could not be claimed as a right under the statute, they declined to permit the inspection claimed by the plaintiffs. On the part of the plaintiffs it is alleged that when the proceedings of any of the Committees have been approved by the Council, and such approval has been recorded, as in the specimen minutes, they are entitled to inspect the minutes of such Committee for the purpose of ascertaining what acts or proceedings of such Committee the Council have approved.

Mr. Russell, on behalf of the plaintiffs, said the question which had arisen in the present case was a peculiar one. The minutes of the Town Council of Manchester were, as the plaintiffs alleged, kept in such a form that it was quite impossible to ascertain what the proceedings actually were. The point to be determined, therefore, was whether the way in which the Corporation had kept the minutes of the Council was such that the plaintiffs were entitled, for the purposes of ascertaining what the proceedings were, to refer to the minutes of the Committees. The minutes of the Council certainly did not give the details of the work done. For instance, the minutes of the Corporation would read, "The proceedings of the Watch Committee having been read, resolved that the same be approved." This rendered it necessary that one should go to the minutes of the Committee referred to in the minutes of the Council and search them to enable one to ascertain what it was the Council had approved. The plaintiffs, therefore, said they were entitled, on the payment of a shilling, not only to see the minutes of the Council, but to see the minutes of the Committees. Counsel admitted that the Manchester Corporation had adopted a form of minute which most skilfully concealed the details of the work done. Thus, if a sum were recommended by the Parks Committee for building a band-stand, the fact of such sum being allowed ought to appear, which it did not on the minutes as now settled. There was no record of order of payment of money. Section 233 was thus rendered nugatory.

Mr. Asquith, for the Corporation, said he appeared for that body to say that they contested this matter in no contentious spirit, but merely to get guidance from the Court as to what was their duty in the matter of the keeping of these minutes. There had been some suggestion of deliberate concealment.

Mr. Russell : Oh, no.

Cave, J., said it was clear that the Council under the Act should let the burgesses know all the acts of the Corporation.

Mr. Asquith said the Corporation had been keeping their minutes in the present form for 60 years, and they had always been willing to allow

the burgesses to inspect the Committees' minutes when it was consistent with the public interest. In some cases it would be most inexpedient to allow the burgesses to see all the preliminary details.

Cave, J. : I think the burgesses are entitled to ask to be shown what has been approved by the Council.

Mr. Asquith : The Corporation, as I understand, are willing to concede that, but what they object to in the public interest is the looking at the Minute Books of Committees which contain preliminary proceedings leading up to the final act.

Cave, J. : There I should agree with you. I do not think they are entitled to do that. But the difficulty is, can you suggest a way in which what they are entitled to see can be reconciled with what they are not entitled to see?

Mr. Asquith : Perhaps a practical solution of the difficulty may be arrived at if the document described as an "epitome," which is submitted to the members of the Council immediately before they meet, and which I am instructed contains a summary of the decisions actually arrived at by the Committees, were treated as part of the minutes of the Council, and allowed to be inspected. But the prayer of this claim is that they may inspect the minutes of proceedings of any Committee.

Cave, J. : That is going rather far, but the difficulty is to see how they should be separated, because the Corporation make the minutes part of the proceedings.

Mr. Russell : All we ask is the right to see the minutes for the purpose of ascertaining what acts and proceedings of such Committee have been approved. If the epitome shows us the acts that will do.

Mr. Asquith : So long as it is made clear that the Corporation are not bound to disclose any confidential preliminary matters to which I referred, they will have no objection.

Cave, J. : I do not see that they are bound to disclose such confidential matters.

Mr. Russell : I admit that I do not see anywhere in the Act of Parliament a right to inspect minutes of Committees as such. I do not think that is what is contended for here. I was referring to the minutes of the Committee so far as they were reported to the Council.

Cave, J. : The epitome will answer your purposes. Mr. Asquith does not object to your seeing that, and I think that will do.

Mr. Russell : The Council are, of course, the masters of the form in which they keep their minutes. As long as they keep them in the present form I cannot ask for any more.

Mr. Asquith : I feel, and the town clerk quite agrees with me, that the form in which the minutes have been traditionally kept does give considerable colour to my friend's claim. I repeat that the Council are willing that the acts of the Committee approved shall be inspected by the burgesses, but not the Minute Books.

Mr. Russell : We have only had the epitome offered to us now. It has been expressly refused down to the present. All we want is a declaration from the Council that the burgesses are entitled to inspect the acts of the Committees approved by the Council.

Mr. Asquith : The acts of every Committee approved by the Council are to be open to inspection.

Mr. Russell : I must ask for all acts submitted for approval, because some acts of the Committee may not be approved.

Mr. Asquith : Yes, I agree that the acts of every Committee submitted for approval are to be open to inspection in the future.

It was agreed that the declaration should be that the burgesses are entitled to inspect the minutes of acts of the Committees submitted to the Council for approval, and an order was made accordingly. After consultation between counsel it was agreed that the plaintiffs' costs in the action should be borne by the Corporation.

The case of WILDE AND OTHERS *v.* CAPE AND DALGLEISH.

(Decided before the LORD CHIEF JUSTICE and a Special Jury, in the Queen's Bench Division, on May 27 1897.)

Auditing—Undiscovered Fraud—Alleged Negligence—Non-Examination of Pass Books—Damages.

In this action the plaintiffs, Messrs. Wilde, Burchell & Burchell, a firm of solicitors, claimed damages from the defendant, Mr. Dalgleish, who carries on business as an accountant at 8 Old Jewry, E.C., under

the name of Cape & Dalgleish, for negligence and breach of duty in auditing the plaintiffs' books and in preparing and certifying their Balance Sheets.

It appeared that the defendant had been employed to audit the plaintiffs' books for the years ending September 30 1890 to 1895, and to examine and certify Balance Sheets for each of those years. The negligence complained of was that the defendant did not carefully examine the plaintiffs' Pass Books and omitted to discover certain fraudulent entries made in them. By these fraudulent entries the plaintiffs' cashier had defrauded them of £1,756 4s. 9d., which sum they now claimed from the defendant. The defendant's case was that all he was bound to do under the terms of his employment was to see that the plaintiff's books were brought to a correct balance and to raise a Balance Sheet and Profit and Loss Account as between the partners, taking the entries and balances appearing in the books as correct. He denied that he was employed to make a cash audit, or check receipts or payments, or examine the Cash Book or Bank Book in any way, or to be in any way responsible for the accuracy of the cash transactions. These, the defendant contended, were the conditions of employment arranged with Mr. Cape, the defendant's deceased partner, by the plaintiffs in 1883. In 1884 Mr. Dalgleish entered into partnership with Mr. Cape, who died in 1889, and since that date he had audited the plaintiff's books with the object above stated—*i.e.*, to ascertain the Profit and Loss Account as between the partners, accepting the accuracy of the entries appearing in the books. He repudiated all responsibility for not having discovered the defalcations of the plaintiffs' cashier.

After evidence had been given by the plaintiffs, during the midday adjournment the parties came to terms.

Mr. Bigham said that his client was unaware of the terms which had been arranged between the plaintiffs and Mr. Cape, and did not know that he was to check the accounts in the Pass Book. After hearing the plaintiffs' evidence as to the arrangements made with Mr. Cape, Mr. Dalgleish thought that, with regard to the loss caused by the defalcations of the cashier, he ought to meet the plaintiffs half-way, and was prepared to consent to judgment for them for £850.

JUDGMENT.

The Lord Chief Justice gave judgment for the plaintiffs for this amount, and added that it was only fair to Mr. Dalgleish to say that the settlement of the case must not be taken as any reflection on his personal skill or care. The difficulty had arisen solely owing to a misunderstanding on his part as to the terms of his employment by the plaintiffs.

The case of THE LONDON AND COLONIAL FINANCE
CORPORATION, LIM.

(Decided before Lords Justices LINDLEY, LUDLOW, and CHITTY, in the
Court of Appeal, on August 7 1897.)

*Company—Winding-up—Directors—Alleged Misfeasance or Breach of
Trust—Meaning of—Obligation to “subscribe” for Shares—Procuring
Allotment to be made to persons approved by the Directors—Companies
(Winding-up) Act 1890, s. 10.*

This was an appeal by the liquidator of the above company against the refusal by Vaughan Williams, J., of the liquidator's summons to make five directors of the company liable in respect of an alleged misfeasance or breach of trust. The case was reported in *The Times* of April 8 last. The company was incorporated in 1888, and in July 1894 an extraordinary resolution was passed that it should be wound up voluntarily, Mr. John Dalgleish being appointed liquidator. In August 1894 an order was made continuing the voluntary winding-up under the supervision of the Court. By the memorandum of association (clause 5) the company's capital was to be £121,200 in £10 shares, the first 120 shares being founders' shares and the others ordinary shares. The clause also provided that the subscribers for the founders' shares should, in addition to paying up the nominal amount of those shares, subscribe for 50 ordinary shares for each founders' share held by them. The respondents to the summonses were Mr. Harry Seymour Foster, M.P., Dr. Gavin Brown Clark, M.P., Mr. Alexander Joseph Morison, Mr. William Marrian, and Mr. Thomas Hovell Atkins, and the summons asked for the following relief against them—viz., (1) a declaration that as directors of the company they in February 1889 combined together to, and did, allot 78 founders' shares to and among themselves and the secretary of the company, in the proportion of 15 shares each to themselves and three shares to the secretary, and further combined together to, and did, abstain from subscribing for or requiring each other or the secretary to subscribe for 50 ordinary shares for each founders' share as required by the memorandum of association; (2) a declaration that the respondents were jointly and severally liable to contribute, as compensation for such misfeasance, £38,220, being the maximum value of the 78 founders' shares, after giving credit for £10 per share received by the company, with interest thereon; (3) in the alternative, a declaration that the respondents were jointly and severally liable to contribute, as compensation for such misfeasance, £23,422 17s. 6d., the aggregate amount of the profits alleged to have been made by the respondents by the allotment of founders' shares and of interest thereon; (4) by way of further alternative, that each respondent might be declared liable to contribute (severally) the following sums:—Mr. Foster, £10,243 2s. 6d.;

Dr. Clark, £4,408 15s. ; Mr. Morison, £3,382 10s. ; Mr. Marrian, a like sum ; Mr. Atkins, £2,006—making a total of £23,422 17s. 6d.

The appeal was heard about three weeks ago, when judgment was reserved.

JUDGMENT.

The Court dismissed the appeal.

Lindley, L.J., read the judgment of himself and Chitty, L.J., as follows :—This is an appeal by the liquidator of the above company from an order of Mr. Justice Vaughan Williams, dismissing a summons seeking to make five directors of the company liable for losses occasioned by a misfeasance or breach of trust. The summons was issued under section 10 of the Companies (Winding-up) Act 1890, and the first thing to do is to ascertain what misfeasance or breach of trust is charged against the directors. A summons such as this is not an indictment, nor are the proceedings commenced by it criminal proceedings. The proceedings are civil, as distinguished from criminal, and the summons is substituted for a writ in an action with a view to expedition and saving of expense. The summons is always accompanied by an affidavit, and the two documents together disclose, or ought to disclose, fully and fairly the case which the respondents have to meet. On the one hand, it is unjust to them to hold them responsible for any conduct which is not made the subject of complaint against them, and, on the other hand, justice to them does not require that the summons should be so closely adhered to and so narrowly construed as to compel the Court to dismiss it because it somewhat overstates the case made against the respondents, and cannot be proved up to the hilt. The wording of a summons can always be amended, if necessary, and the limit of the power is set by a sense of justice and not by any hard-and-fast technical rule. Having made these preliminary observations, we pass to consider what the case made against these five directors really is. We understand it to be, broadly and in substance, that they allotted to themselves and the secretary of the company 80 founders' shares without taking 4,000 ordinary shares which they ought to have taken. The relief specifically asked is for any account of the profits made by so doing, but other relief is also sought, and, if the misfeasance or breach of trust alleged is proved, and loss has been thereby occasioned to the company, whether by loss of profits which would otherwise have accrued to it or in any other manner, the respondents can properly be ordered to make good that loss, even although the evidence might not establish any such combination or conspiracy as is charged in the summons and affidavit. On the other hand, the summons cannot be treated as an application to put the respondents on the list of contributories in respect of the ordinary shares which they respectively ought to have taken. The

company was registered on the 9th of August 1888. The memorandum of association (clause 5) declared that the nominal capital was £121,200 in shares of £10 each, of which 120 were to be founders' shares and 12,000 ordinary shares. The first 120 shares (Nos. 1 to 120) were to be founders' shares, and each subscriber for a founder's share was required, in addition to paying up the nominal amount of that share, to subscribe for 50 ordinary shares for each founder's share held by him. The profits were divisible as follows :—first, the holders of the ordinary shares were to be paid out of the net profits a dividend of 10 per cent. on the amount paid up on their shares ; secondly, the rest of the profits were to be divided into halves, one of which was to be distributed amongst the ordinary shareholders and the other amongst the holders of the founders' shares, and as to both halves and classes of shareholders, *pro rata* according to the number of shares and the amounts paid up thereon. By the articles of association the shares were placed under the control of the directors, who might divide them into two or more issues (art. 6.) ; the directors could refuse to register a transfer of shares to any undesirable person or to any person indebted to the company (art. 28) ; the first directors were Dr. Clark, Mr. Atkins, Mr. Foster, Mr. Judd (who retired early), Mr. Marrian, and Mr. Morison (art. 91) ; the general management of the company's business was vested in the directors (art. 110) ; it was for them to recommend dividends, but the provisions as to the declaration and payment of dividends contain nothing material to the present inquiry. Pausing here, it is to be observed that the persons who at any time held the founders' shares allotted would be entitled to half of any dividend which might remain after paying 10 per cent. on the ordinary shares, so that the holders of all the founders' shares allotted would not, as a body, gain any advantage in the way of dividend by increasing the number of founders' shares held by them. As between themselves, those who held most founders' shares would obviously be entitled to more dividends than those who held a less number. It is also to be observed that, by the memorandum of association and section 11 of the Companies Act 1862, every subscriber for a founder's share was bound to subscribe for 50 ordinary shares. But the duty to subscribe for 50 ordinary shares arose after, and not before, subscribing for a founder's share. The founder's share was to be " held " before the obligation to subscribe for the ordinary shares arose, and no founder's share could properly be said to be " held " before it was allotted. Again, no time is mentioned within which a subscriber for a founder's share was to subscribe for 50 ordinary shares, so that a reasonable time for this purpose must be implied. But for such a purpose as this a reasonable time might no doubt be a short time, considering the fluctuating value of shares and the nature of the transaction. Moreover, nothing is said about the price to be paid for the ordinary shares. But no person taking a founder's

share and thereby becoming bound to take an ordinary share would be liable to pay more than its par value—*i.e.*, the nominal amount, if and when called up. The meaning of the word "subscribe" in the memorandum is by no means clear. It may mean personally take, or it may mean take oneself or find someone to take instead of oneself. The directors understood the word in the latter sense, and we think most business men would so understand it, and would think that an obligation to subscribe for such things as transferable shares was performed, or at all events satisfied and discharged, by procuring an allotment to be made to persons approved by directors. Even if "subscribe" means "take," we are not satisfied that the obligation to "take" could not be satisfied and discharged by the acceptance by the directors of a nominee of the person bound to take, although if "subscribe" means "take" the directors might no doubt refuse to accept a nominee as an allottee and might refuse to register him otherwise than as a transferee from the person personally bound to take. But our own opinion is that in this memorandum of association "subscribe" does not mean "take" personally. The memorandum does not say take or apply for, but "subscribe for," and, in our opinion, an obligation to "subscribe for" shares in a company can, unless there be something in the context to the contrary, be performed by procuring other persons to apply for and take such shares. There may, no doubt, be circumstances to show that "subscribe for" is used in the sense of "apply for and take." Such, we should say, would be the meaning of the words if they had reference to qualification shares, or if there was anything to show that the holding of shares by the person to subscribe was important. But we can discover nothing to show that it was important that the allottee of a founder's share should himself personally acquire 50 ordinary shares. It is plain that if he acquired them he could the next day transfer them to somebody else if approved by the directors; and this, to our mind, shows that it is quite immaterial whether an allottee of a founder's share takes the ordinary shares himself or procures others to take them. It was contended that a person taking a founder's share ought himself to take 50 ordinary shares, so as to be liable to be put on list B if the company were wound up within a year after he had parted with them. This contention carries no weight with us; it is unbusinesslike. The allottee of a founder's share might be any person approved by the directors, and the chance of putting him on the B list would never enter anyone's head. The obligation to "subscribe for" 50 ordinary shares for every founder's share would, in our opinion, be performed by procuring from the directors an allotment to one or more other persons of 50 ordinary shares for every founder's share taken by the subscribers. We have looked into the authorities for guidance on this point, but we can find none which is of any use. Statements in a prospectus that so many or a large number of shares have been subscribed have been

properly held untrue where no one had agreed to take the number specified, or more than a very few, or where the only shares taken were fully paid up shares taken in payment of a debt owing by the company (see *Arnison v. Smith*, 41 Ch.D. 348, and *Henderson v. Lacon*, 5 Eq. 249), but those cases are of no assistance for the decision of the question we are now considering. That question, however, is of great importance in this case. As will appear presently, the directors took 15 founders' shares each, and no ordinary shares in respect of them; but they contend that they found others to take 50 ordinary shares for every founder's share taken. Whether this is true or not will be examined presently, but if true the directors will, in our opinion, have performed the obligation imposed upon them by clause 5 of the memorandum of association. Having made these observations on the memorandum and articles of association we pass on to what was done, omitting all details, except such as are really necessary for the determination of the present appeal. On September 26 1888 shares were allotted to various persons. Mr. Foster took four founders' shares and 200 ordinary shares. The other respondents took the founder's share and 100 ordinary shares each. No one quarrels with this transaction; it was perfectly regular, and we only allude to it in order to show that the respondents then acquired all the advantages as regards dividends which by the memorandum of association were conferred on the holders of founders' shares. On the same day the directors purported to allot 80 founders' shares and 4,000 ordinary shares to two gentlemen in Australia named Michael and Collier. This was done pursuant to a resolution previously come to and in the belief that Michael and Collier had authorised Mr. Foster to apply for these shares on their behalf. It afterwards appeared that Michael and Collier were not bound to take and refused to take these shares, and the allotment to them was cancelled on February 26 1889. [His Lordship then referred to the issue of a prospectus in October 1888, and continued.] It is clear now that the cancellation of this allotment was *bonâ fide* and unimpeachable, and it is unnecessary to allude to it further. But on this same February 26 1889 the 80 founders' shares thus set free were allotted as follows:—15 to each of the respondents and five to the secretary of the company. Morison was abroad at this time, but when he returned he accepted 15 founders' shares. Although the 80 founders' shares were thus dealt with, the 4,000 ordinary shares were not then dealt with at all. There was no allotment of them. This is the cardinal fact in the case, and it is this fact which has given rise to the summons with which we have to deal. [His Lordship then referred to the evidence, and continued.] It follows from what we have already stated, when commenting upon the memorandum of association, that the view taken by the directors, viz., that they were not bound to take the shares themselves, but were at liberty to find persons to take the 4,000 ordinary shares, was correct in point of law; and, if so, the

next question is, whether they performed their obligation in this respect. [His Lordship referred to the liquidator's cross-examination, and continued.] The only just inference which can be drawn from this evidence and Mr. Foster's is that the directors discharged their obligation to subscribe for the 4,000 ordinary shares by procuring them to be taken by other persons who have duly paid the company for them. Whether this was done in a reasonable time need not now be inquired into, for, assuming it was not, the company have suffered no loss attributable to the delay. On the contrary, they have made a large profit. The only possible grounds that we can discover for saying that the directors did not fulfil their obligation as regards the 4,000 shares are (1) that it was their duty to take them themselves, and (2) that the 4,000 shares actually taken by other persons ought not to be attributed to the 80 founders' shares, but ought to be treated as allotted in respect of applications made without reference to them. The first ground we have already given our reasons for being unable to assent to. The second ground we have carefully considered, and it is, in our opinion, not in accordance with the facts. [After commenting on the evidence on this point, his Lordship added.] We have dwelt at length on this part of the case, because it is the only part which, in our opinion, presents any difficulty. If the respondents are not liable for any breach of duty in taking the 80 founders' shares without the corresponding 4,000 ordinary shares, the summons against them must be dismissed. The only other charge against them to which we need refer is that they took the founders' shares at par when they had information which, if made known, would have made those shares much more valuable. [After examining the evidence, his Lordship continued.] In acting as they did the directors were guilty of no breach of duty to the company. They are charged, indeed, with having acted *mala fide*, and with having conspired together in order to acquire for themselves profit which they foresaw would accrue to the company, and which it was their duty to secure for the company. This charge entirely breaks down on the evidence. The learned Judge who saw the witnesses believed their statements, and there is nothing, except suspicion, to support such a charge. This part of the case has been so fully gone into by Mr. Justice Vaughan Williams that it is unnecessary for us to say more about it. His Lordship then referred to a small incidental point, and concluded his judgment thus:—The conduct of the directors, not only in this matter, but in allotting the 80 founders' shares as they did, without recording in any way what they did, or proposed to do, with the 4,000 ordinary shares, naturally excited very grave suspicion, and they cannot justly complain of the close investigation which has been the result. We agree, however, with Mr. Justice Vaughan Williams that they have not been guilty of any breach of duty or breach of trust. The appeal must, therefore, be dismissed.

Lord Ludlow, L.J., concurred in the result, but read the following separate judgment:—I agree with the result arrived at by the other members of the Court, but I differ from them with regard to the construction of clause 5 of the memorandum of association. I construe that clause more strictly than they do. I do not propose to give any general definition of the word “misfeasance,” but I think for the purpose of this case it may be defined to be a breach of duty or trust by the directors, resulting in a loss to the company. Mere allotment of shares, whether ordinary or founders’ shares, by directors to themselves is not unlawful, nor a breach of duty or breach of trust. Mere error of judgment would not be sufficient to support a misfeasance summons. The charge made against the directors, shortly put, is this—that they combined together to allot, and did allot, amongst themselves, 80 founders’ shares, and combined to refrain from subscribing, or from requiring each other to subscribe, for 50 ordinary shares of the company for each founder’s share so allotted to them. There is no evidence of any conspiracy, but the directors did allot to themselves 80 founders’ shares—15 for each director and five for the secretary—without having allotted to them at the same time the corresponding number of ordinary shares attributable to the 80 founders’ shares. [His Lordship read the material part of clause 5 and continued.] I read “subscribe” as equivalent to “pay and take.” It is contended by the directors that they were not required by clause 5 to have the ordinary shares allotted to them at the same time that they took the allotment of the founders’ shares, and that they discharged their obligation to take ordinary shares by subsequently and within a reasonable time procuring other approved persons to take the ordinary shares which were attributable to their founders’ shares at a large premium; that, in fact, there was no personal liability to take them, and that they might comply with clause 5 by procuring others to take them within a reasonable time. This appears to me an inconvenient and an erroneous construction of clause 5. The price of the shares would fluctuate, and it would be difficult to tell what a reasonable time in a case like this meant. If the directors took the ordinary shares with the founders’ shares they took them at par, and no difficulty would arise. But suppose they waited for some time before the shares were allotted to them, are they to be allotted at par price, or at the price they bore in the market at the time of the allotment? The founders’ shares were very valuable, and must have been intended as an inducement to the allottees to take the prescribed number of ordinary shares which belonged to each founder’s share. What is the meaning of clause 5? It means, in my opinion, that the subscribers, or, in other words, the takers or allottees of the founders’ shares, on having such founders’ shares allotted to them, are then and there to take as an inseparable part of such founders’ shares (each of them to take) automatically and simultaneously 50 ordinary shares and

become liable for them—they are to become then and there just as much the owners of the ordinary shares as they are of the founders' shares, and should be then and there placed on the register for them. They may, if they please, the next day transfer them to whomsoever they think fit, provided the transferee be approved by the directors. In my opinion the directors and secretary have always since February 26 1889 been the owners of these 4,000 ordinary shares. That this was the course adopted before February 26 1889 is clear from the affidavit of the liquidator. I am not prepared to say that the directors have not acted *bond fide*. Clause 5 of the memorandum is difficult to construe, and the directors may have innocently mistaken what I believe to be its effect; nor can I say that there has been any loss to the company. The misfeasance is not, therefore, made out. Whether the directors are liable to be placed on the list of contributories does not arise under this summons, and I say nothing about it.

A discussion then took place as to the costs of the appeal, after which

Lindley, L.J., said that the appeal would be dismissed with costs, to be paid out of the company's assets, not by the liquidator personally. The liquidator was perfectly justified in investigating the matter, the circumstances being very suspicious.

The case of MARTIN v. ISITT.

(Decided before Lord Chief Justice RUSSELL and a Special Jury, on 3rd and 4th March 1898.)

Auditors—Action for Alleged Negligence—Defence that the Proper Materials were not supplied to do the Work.

This was an action brought by Messrs. James Martin & Sons, milk and grain merchants, against Messrs. Isitt & Co., Chartered Accountants, for negligence in not checking the Cash Book and the Bank Pass Book, whereby a clerk was enabled undiscovered to embezzle £612 19s. 2d., the property of the plaintiffs. The defendants alleged that they were unable to properly proceed with their agreed work owing to the neglect of the plaintiffs to give proper facilities, and in particular they complained that the books were not properly posted up and were full of errors, of which the defendants were unable to get the necessary explanations.

Mr. E. Tindal Atkinson, Q.C., and Mr. Haigh were for the plaintiffs; Mr. Carson, Q.C., and Mr. T. M. Stevens for the defendants.

It appeared that in 1887 Mr. Eldrid, now a member of the defendants' firm, agreed with plaintiffs to do certain work which was not material to the present action, and also undertook the "monthly checking of all your books" for an inclusive fee of thirty guineas, afterwards increased to sixty guineas. It was not the defendants' duty to audit, but merely to "check" the books. To enable this to be done clerks were sent down to the plaintiffs' head office at Brockley, and they spent there a very considerable number of hours doing the requisite work. The books were written up and posted by the plaintiffs themselves; with this the defendants had nothing to do. It further appeared that a man named May, in charge of a branch of the plaintiffs' business, received money, and in a weekly statement sent to the plaintiffs credited himself with payments into a bank, which payments should in ordinary course appear in the London and County Bank Pass Book of the plaintiffs. In fact, from the last week of November 1896 until the end of March 1897 he habitually embezzled the money. The plaintiffs would enter in their Cash Book the amount alleged by May to have been paid into the bank; the Pass Book, of course, would not agree with the Cash Book, and the plaintiffs complained that this was not discovered until the first days of April 1897. It was admitted that the discovery was made by, and was due to the work of, the defendants; but it was then alleged against the defendants that the discovery should have been made earlier. The reply of the defendants to this was that the state of the books was such, and the queried items—the explanations of which were constantly delayed—were so numerous, that they were unable to proceed fast enough to keep pace; and that, in December 1896, they were still engaged in dealing with the entries relating to the summer months of 1896. Further, they said that they were requested by the plaintiffs not to proceed with the work in January and that the month of February was wasted away to the default of the plaintiffs. The senior member of the plaintiffs' firm was called, and gave evidence supporting his own and negating the defendants' case, but his cross-examination was not concluded when the Court rose for the day.

Before resuming the hearing the next morning, a consultation took place between counsel, and as a result, Mr. Carson stated that he understood that it would not now be contended that the defendants had been negligent or unskilful in the way in which they had done their work, but that the plaintiffs would rest their case on a breach of one term of the contract, viz., the agreement to attend monthly. That being so, and recognising that the plaintiffs had suffered a loss, the defendants were quite willing to share that loss to a certain extent, and consequently terms had been arranged.

The Lord Chief Justice said that as he understood the case as placed before him, no allegation of negligence or unskilfulness was now made,

but that it was urged that the defendants should have attended somewhat earlier than they actually did; that was a question to be tried, but he thought the action of the parties in arranging the matter to be very proper.

The case of THE COOLGARDIE CONSOLIDATED GOLD MINES,
LIM.

(Decided before Mr. Justice WRIGHT, in the Chancery Division, on
March 9 and 16 1898.)

*Company—Winding-up—Contributory—Issue of fully paid-up Shares—
Filing of Contract with Option to make Payment in fully paid-up
Shares—Issue of Shares as fully paid-up in Exercise of Option—
Liability of Shareholder—Companies Act 1867 (30 & 31 Vict. c. 131),
s. 25.*

In 1895 the Y. Exploring Company, Lim., agreed to sell certain mining claims to the C. C. Gold Mines, Lim., upon the terms that, as to part of the purchase-money, the directors of the purchasing company might discharge it either wholly in cash, or partly in cash and partly in fully paid-up shares, or wholly in fully paid-up shares, and for that purpose certain shares were agreed to be set aside for issue to the vendors in case the directors should decide to discharge the purchase-money in shares; and such shares were to be "issued solely as fully paid-up shares without any liability whatsoever accruing thereon." In exercise of this option, the directors decided to discharge the purchase-money in fully paid-up shares. This contract was duly filed with the Registrar of Joint Stock Companies under section 25 of the Companies Act 1867, before the issue of the shares. The company was now in liquidation, and the names of certain holders of these shares had been placed on the list of contributories in respect of the whole amount of these shares, on the ground that the requirements of section 25 had not been complied with by the filing of such a contract. This was a summons by these shareholders for the exclusion of their names from the list of contributories on the ground that these were fully paid-up shares within the meaning of section 25.

JUDGMENT.

Held, that, upon the plain language of the section, these shares were not fully paid-up shares, because at the time of their issue the whole contract under which it had been "otherwise determined" was not filed, the contract to issue the shares not having been arrived at till the

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option was exercised, and nothing to show this having been filed till after the issue of the shares. Held also, that the applicants, being in the position of allottees and not transferees, could not rely on the representation in the share certificates that they were fully paid, as estopping the company from denying that they were fully paid.

The case of COX *v.* EDINBURGH AND DISTRICT TRAMWAYS
COMPANY, LIM.

(Decided before Lord KYLLACHY, in the Outer House of the Court of
Session, on June 16 1898.)

Wasting Capital and Dividends.

Lord Kyllachy gave judgment in the suspension and interdict at the instance of Robert Cox of Gorgie, M.P., residing at 34 Drumsheugh Gardens, Edinburgh, against the Edinburgh and District Tramways Company, Lim., 1 South Charlotte Street, Edinburgh. The complainer seeks to have the respondents interdicted from declaring or paying any dividend on any shares of the company out of the capital of the company; from paying any dividend except out of the net profits of the whole business of the company; and from declaring any dividend until due provision has been made out of the net revenue for loss of capital or depreciation of assets on Capital Account; and, in particular, until the sum of £20,000 or other loss arising on the realisation of the existing stock of horses, cars, and plant has been provided for.

Lord Kyllachy said:—This is an action brought by a shareholder of the Edinburgh Tramways Company by which he seeks to restrain the respondents from paying a certain dividend for the first half of the current year 1898; or at least from paying that dividend until provision is made for a certain loss, which, it is stated, has arisen, or is about to arise, upon the realisation of the existing stock of horses and cars belonging to the company. The respondents dispute the relevancy of the complainer's statement, and the parties (without renouncing probation) are agreed in asking a judgment on relevancy. They are also agreed that for that purpose a certain minute of admissions shall be taken as forming part of the complainer's statement. The facts upon which the complaint is rested are, shortly, these. The respondents—a limited company—hold (in substance) a lease for a term of years of the Edinburgh tramways. They pay a rent to the Corporation for the heritable subjects, and their business consists in working the tramways, for which purposes they provide the necessary rolling-stock, including

a number of cars and horses. It has lately been arranged that, in consideration of an increased rent, the Corporation shall convert the tramway lines into what is known as cable tramways, and the existing stabling into a station or stations, for the fixed machinery required for working the cables. This conversion, it is said, although not yet completed, will be so in the course of the present year; and, of course, the result will be to supersede the use of horses for haulage, and also, to a large extent, to supersede the existing cars by cars of a different construction. What the complainer alleges is that, upon the sale which must follow of the horses and cars at present in use, there will be a loss to the company of over £20,000—that is to say, a difference of that amount between the prices realised and the cost or value of the horses and cars as at present standing in the company's books. He also alleges that the cost to the company of providing new cars and "grippers" will be about £45,000, and that in addition there will be the cost of cables for the entire system. He does not allege or suggest that the conversion in progress is not and will not be beneficial to the company, or that the directors of the company have not fully considered its effect on their financial position, or that anything has been, or is being, done which will leave the company with assets insufficient to pay its debts. His case simply is that the transaction involves an element of a certain sacrifice of existing assets. That is, as I read it, and as I think it must be read, the meaning and substance of his averments, and in particular his statement that "It is believed and averred that there will be a loss or depreciation upon the assets of the company in respect of such realisation, amounting to not less than £20,000." I do not go into the question as to an additional alleged loss on temporary stabling; or as to the sufficiency or insufficiency of certain sums paid out of revenue into Suspense Accounts, to meet that and other alleged losses. For the purposes of the argument it seems enough to take the alleged prospective loss in the realisation of the horses and cars. That is sufficient to raise the complainer's case. For I must at least at this stage assume, what the complainer states, that the sum at the credit of the Suspense Account is quite inadequate to meet the alleged loss or deficiency on the horses and cars. Now I have had a full and very able and interesting argument on a general question which has of late years occupied, it is said, the attention of the English Courts—the question, namely, whether and how far loss or depreciation of assets forming the capital stock of a limited company bars the payment of dividend until that loss or depreciation has been recouped. It was, on the one hand, contended that the principles as applied and expounded by the English Court of Appeal in the cases of *Lee v. Neuchatel Asphalte Company* (41 Ch.D. p. 1) and *Verner v. General Investment Company* (2 Ch. (1894) p. 239) are conclusive against the complainer—establishing, as it is said these cases do, that with respect to fixed or

permanent, as distinguished from circulating or floating, capital, there is no rule of law by which such capital must be maintained at its original or any particular value ; but that, on the contrary, so long as there is a surplus, sufficient for dividend, of annual revenue over annual outgoings—that is to say, a surplus arising on a Revenue Account properly kept—the state of the company's Capital Account is, as affecting dividend, a matter of no moment. On the other hand, it was argued for the complainer that the decisions referred to have not yet been considered by the House of Lords ; that they are contrary to previous decisions, and are not well founded in principle. It was further argued that, even assuming the law to be as there held with respect to fixed capital or assets, the horses and cars here in question are not properly assets of that character. They are, it is said, subject to continuous waste, and to waste requiring to be replaced, and that such waste (or, rather, the cost of its replacement), however large and however caused, must always and necessarily form a charge against revenue. Now, I may not perhaps be bound by these English decisions, although, of course, they are decisions of high authority ; but I may say at once that I have no difficulty in accepting not only their results, but their general doctrine. At the same time, I do not myself see that the respondents in this case require to appeal to those decisions or to the principles new or old there expounded. Nor, on the other hand, am I quite clear that if the respondents' defence did require such an appeal, such appeal (I mean as an appeal to those particular authorities) would be entirely conclusive. The view I take of the present case is shortly this. It is not at all, in my opinion, a case such as might have presented itself if, for example (the respondents still working the tramways by horse traction), a fire or other catastrophe had occurred by which, say, their horses perished, and their cars were destroyed. In that case there would, of course, have been beyond question a loss of assets in the most real sense, and a loss beyond doubt requiring to be replaced. And that being so, questions I think of some difficulty would or might have occurred as to how far the necessary replacement could properly or justifiably be charged to capital. It does not, however, appear to me that (taking the facts of this case as they appear on the complainer's statement and the minute of admissions) we have here to deal with anything which can be considered as in any real sense a loss or depreciation, actual or prospective, of the respondents' assets. The selling off of their horses and cars is, or will be, a voluntary act on the part of the company. It is part of a scheme or transaction on which the company has embarked presumably for the benefit and not for the detriment of their undertaking, and if such scheme or transaction involves, by reason of enforced sale or otherwise, a sacrifice in one direction, such sacrifice will at least presumably be compensated by a corresponding gain in some other direction. I am, I think,

entitled to hold that that is the view of the directors and of the company. I am also, I think, entitled to hold that they entertain that view on reasonable grounds—grounds, at all events, which are not impeached by the complainer. But if that is so, it is surely a strong suggestion that I should assume without inquiry that the company, as a going concern, will suffer upon the total transaction a loss equal to the loss on its discarded assets, or, on the other hand, that I should allow a proof as to the effect on the company's general assets of the proposed conversion from horse to cable traction. I am certainly not prepared to make such an assumption, nor, on the other hand, am I prepared to allow such a proof except upon averments of a quite different kind from those with which I have here to deal. In saying so I do not proceed on any law or doctrine established or said to be established by recent decisions. I proceed on a principle as old as the beginning of company law—the principle, namely, that in matters of the kind here in question—matters necessarily of estimate and opinion—a company is presumably the best judge of its own affairs. In such matters the Court will not readily interfere with the company's action, and it will not do so at all except on averments which involve practically a case of fraud or dishonesty. The truth is that the complainer's argument involved, as it seemed to me, the assumption that capital sunk—that is to say, capital not represented by tangible and available assets—is in all cases to be considered as capital lost. Of course, if that were so, the question or kind of question would here arise which arose in the two English cases of which we have heard so much; but such a proposition has never, so far as I know, been, as yet at least, advanced. The case suggested by Lord Justice Lindley, of expenditure made in starting a newspaper, is a very good illustration of the impracticability of such a doctrine. But, apart from extreme cases, few things are, I should think, more common in ordinary business than operations of the kind with which we are here concerned. A merchant or manufacturer desires to enlarge his premises, satisfied that it will pay him to do so. He accordingly pulls down old buildings which have a certain value, and he replaces them by others at perhaps great cost. There is thus, of course, in a sense, the sacrifice of a permanent asset, and it may quite well happen that the new buildings if put into the market would not fetch a sum equal to the value of the old building plus the cost of the new. But for the purposes of the trader's business the result may be entirely the other way, and the presumption is that the trader is satisfied that it is so. If he is so satisfied he will certainly not consider that he has sustained a loss of capital, or feel bound to carry the cost of the old building to the debit of his Profit and Loss Account for the year. Similarly a manufacturer requires or resolves to discard certain machinery and to replace it with other machinery more effective or more economical. Here, again, the sacrifice in the case of the old

machinery is simply an item in the cost of the change. So, also, when a railway company, as sometimes happens, alters its gauge or substitutes, say, steel for iron rails. The operation necessarily involves a sacrifice of old material. But the assumption always is that the operation as a whole enhances the value of the concern or undertaking. And although it may be a prudent and proper thing to provide for the recurrence of such expenditure, and to set up a renewal is a question which the trader considers for himself, and one as to which, even in the case of limited companies, Courts of law are not accustomed to interfere. On the whole matter I am of opinion that the complainer has stated no relevant case for interfering with the proposed dividend, or for granting him interdict in terms of any part of his prayer.

His Lordship accordingly refused the note, with expenses.

The case of REG. v. WILLIAMS.

(Decided before Lord RUSSELL, L.C.J., BRUCE, KENNEDY, RIDLEY, and DARLING, JJ., on 23rd January 1899.)

Falsification of Accounts.

This was a case stated for the consideration of the Court for Crown Cases Reserved from the quarter sessions for Cornwall.

The prisoner was convicted of falsifying accounts. He was collector of poor rates for the parish of Perranuthnoe, and had entered in the overseers' accounts with the parish a "balance in hand £131 10s. 5d.," though that money was not forthcoming. The facts sufficiently appear from the judgment, in which the conviction was upheld.

JUDGMENT.

The Lord Chief Justice said in this case the prisoner was indicted under 38 and 39 Vict., c. 24, section 1, for falsifying accounts. The facts were that on April 10 1890, the prisoner was appointed collector of poor rates for the parish of Perranuthnoe, in Cornwall, and he remained in that post. It appeared that there were two sets of accounts kept, one of which was referred to in the seventh and eighth counts of the indictment. This would appear to have been an account between the prisoner and the overseers; but no evidence had been offered at the trial on those charges. There was a second account which the prisoner kept for the overseers of the state of accounts between them and the parish. It was in respect of that account that the charges were made. That account was one which showed on the debit side the moneys

received from the poor rates and the balance, if any, from the last account, and on the credit side the moneys paid away by the overseers, as, for instance, to the treasurer of the union, or the parish council, or for salaries, &c. That being so, what was said to be the falsification? It was this—that the prisoner, with intent to defraud, made an entry thus, “balance in hand £131 10s. 5d.” Was that entry true or false? So far as could be seen that was perfectly true, for it stated that £131 10s. 5d. was due from the overseers in respect of that account. If the balance had been stated in any other way it would have been erroneous. But it was stated that it must be taken to mean that the prisoner had that sum in his pocket, whereas he had in reality spent it. It certainly did not mean anything of the kind. If it had been his own account with the overseers different considerations would have applied; but, looked at as an account between the parish and the overseers, it was literally and exactly true, and the auditors had found it correct. It was quite true that the defendant had told one of the overseers a lie, for in answer to a question on the subject he had said that the money was all right when it was really gone, and it might be that the prisoner could have been convicted of embezzlement; but there was no evidence of falsification of accounts, and the appeal must be allowed.

The other learned Judges concurred.

The case of THE NATIONAL BANK OF WALES, LIM.

(Decided before the MASTER OF THE ROLLS, the PRESIDENT OF THE PROBATE DIVISION, and Lord Justice ROMER, in the Court of Appeal, on the 2nd August 1899.)

Company Liquidation—Misfeasance Summons—Bank—Advances made without proper Security—Provision for Bad and Doubtful Debts—Dividends out of Capital.

Judgment was delivered upon this appeal against a decision of Wright, J., reported in *The Times* of December 8 last and in *The Times Law Reports*, vol. 15, p. 88. The liquidator in the winding-up of this company under the supervision of the Court issued a summons against Mr. John Cory, a former director of the company, asking for a declaration that he as director was guilty of misfeasance or breach of trust (1) in authorising, sanctioning, or participating in the payment to shareholders of the company of interest or dividends on their respective shares out of the capital of the company,

and was liable and might be ordered to repay to the liquidator the amount so paid during the period in which he acted as director; (2) in making or sanctioning improper advances out of the funds of the company in contravention of the articles, whereby a loss accrued to the company, and that he might be ordered to pay to the liquidator the amount of that loss; (3) in making or sanctioning improper advances to customers, and allowing overdrawn accounts and debts of customers to continue, with knowledge that those customers were, or were reputed to be, insolvent or otherwise unable to pay the amount of their indebtedness, whereby a loss had accrued to the company, and that he might be ordered to pay to the liquidator the amount of that loss. An agreement was, on February 23 1893, entered into between the bank and the Metropolitan Bank of England and Wales for the purchase by the latter company of the assets and goodwill (other than the uncalled capital) of the National Bank, the Metropolitan Bank undertaking to satisfy the liabilities of the National Bank. In case the assets and goodwill should prove to be of less value than the liabilities, the National Bank or their liquidators were to call up sufficient of the uncalled capital to pay the deficiency. The agreement was made conditional upon the shareholders passing resolutions for the voluntary winding-up of the bank. This was afterwards done, and the agreement was approved by the shareholders and was carried out. There was an amount of £7 10s. per share uncalled upon the shares of the National Bank. In the result it turned out that the value of the assets and goodwill was less by about £41,000 than the amount of the liabilities. The creditors of the National Bank had been paid, and this summons was taken out really in order to obtain payment by means of it of the above-mentioned deficiency of £41,000. Wright, J., held that the claims (2) and (3) made by the summons had not been established, but he held that claim (1) had, and he ordered Mr. Cory to pay to the liquidator a sum of £37,000, with interest at 5 per cent. The interest amounted to over £17,000. Mr. Cory appealed, and the liquidator gave a cross notice of appeal with regard to the claims (2) and (3) which had been dismissed. The cross notice asked that, "For the purpose of ascertaining the amount of the liability of the said John Cory in respect of the matters aforesaid, all necessary accounts and inquiries may be directed to be taken and made; and that in taking and making such accounts and inquiries the whole period during which the said John Cory acted as such director, as aforesaid, may be considered, notwithstanding that six years may have elapsed from the commencement thereof, on the ground that the losses arising from the wrongful acts aforesaid and that the true state of affairs of the said company were fraudulently concealed by the said John Cory, and that the said John Cory issued Balance Sheets that were false to the knowledge of the said John Cory, and, moreover, that parts of such interest and

dividends were retained by the said John Cory and converted to his own use as a shareholder of the company."

JUDGMENT.

The Court allowed the appeal, and dismissed the cross appeal.

The Master of the Rolls read the judgment of the Court, in which, after stating the order appealed from and the grounds alleged by the liquidator in his notice of cross appeal, his Lordship continued as follows:—The appeal and cross appeal thus require the Court to examine into Mr. John Cory's conduct as a director of this company from the time when he became a director in 1884 until he ceased to be so in December 1890, or even later, if the liquidator is correct. The order under review was made on a summons issued under section 10 of the Companies (Winding-up) Act 1890, on June 14 1895, a date which is material, having regard to the Statute of Limitations on which Mr. Cory relies as a defence to the greater part of the demands made against him. It will be convenient to consider his appeal first. This raises the question whether the funds of the company have been misapplied in payment of dividends, and, if they have, then whether Mr. John Cory is liable for that misapplication. Before examining the controverted facts, and discussing the legal questions which arise, it is desirable to state shortly the history of the company, and how the present controversy has arisen. The National Bank of Wales is a limited banking company formed in 1879. Its objects were to carry on the business of bankers, including the making of advances and the acquisition of other businesses. Its capital was £2,000,000, divided into 100,000 shares of £20 each. The shares issued were never paid up in full, £10 being paid up and the remaining £10 being uncalled, and forming, therefore, a large sum available in case of need. The number of shares increased from time to time. In 1884 the paid-up capital amounted to £125,000, and it so remained until 1890, when it was increased to £225,000. The articles of association, which require notice, are the following:—(15) Gives the company a lien on all the shares held by any shareholder indebted to the company and gives the directors a power to sell the shares of any such shareholder; (78) enables any director to resign, and on the acceptance of his resignation by a board his office is vacated; (82) makes audited accounts approved by a general meeting conclusive, except as regards errors discovered within three months; (82, 83) entitle the directors and officers to indemnity, except against their own wilful acts and defaults; (86) entrusts the management of the business of the company to the board of directors. Article (98*b*) empowers the board to appoint and dismiss branch managers and the general manager; (98 *c* and *h*) empower the board to lend money or give credit with or without security. But there

is (in 98c) a proviso "that no advances without security shall be made or credit given" to any director; (99 and 100) relate to the general manager; (105) requires the directors to cause proper accounts to be kept, so as to show the true state and condition of the company; (108) requires them to lay before every ordinary meeting a proper Balance Sheet, accompanied by a report as to the state and condition of the company, and as to the amount, if any, which they recommend to be paid out of the profits by way of dividend; (109 to 118) provide for auditing the accounts. The auditors are to have access to the company's books and accounts. By (116 and 117) they are to have copies of the statements proposed to be laid before the general meetings, and it is declared to be their duty to examine the same with the accounts and vouchers relating to them, and to make a report thereon, and also to examine and report on the assets of the company. The auditors are also to report errors and irregularities to the board; (119) empowers the directors, with the sanction of a general meeting, to declare dividends in proportion to the amounts paid up on the shares, and also authorises the payment by the directors of interim dividends out of the profits of the bank accrued in any half-year ending June 30; (120) empowers the directors to set aside out of the profits a reserve fund, and no dividend exceeding 6 per cent. per annum shall be paid until the reserve fund amounts to one-fifth of the paid-up capital; (121) says the reserve fund may be applied to meet contingencies, equalise dividends, repairs, or any other purpose of the company which the board may think fit. The company's principal bank and its head office were at Cardiff, where the directors met and the general manager was in daily attendance. The company had also many branch banks, each with its own manager. The course of business was this. Each branch manager sent weekly to the head office what is called a weekly state—*i.e.*, an account showing how the assets and liabilities of the branch stood, what advances or overdrafts had been made or allowed, and to whom, what securities the bank held, and other matters. Every quarter each branch manager made a more formal return to the head office, showing the position of the branch and the business done during the past quarter. It was the duty of the general manager to examine these documents, and to report to the board anything disclosed by them which required their attention. The weekly states and quarterly returns were in the board room for reference in case of need, but, unless attention was called to them, the directors did not think it necessary to examine them. The chairman of the directors was Mr. Thomas Cory, a brother of Mr. John Cory. The chairman and the general manager (Mr. Collins) visited each branch bank every year; and in addition two skilled inspectors frequently went round and inspected the accounts and reported to the general manager. The accounts of the branch banks appear, however, not to have been separately audited by professional

accountants. The auditors employed to examine the company's accounts, and to certify the annual Balance Sheets and accounts laid before the shareholders, only saw the head office books and the returns from the branch offices, certified by their respective managers, to the head office. These certified returns formed part of the weekly states, but omitted much that they contained. The minutes of the directors' meetings show that, speaking generally, they attended with reasonable regularity and transacted a large amount of business. No director, unless it was the chairman, attended to any details not brought before the board either by the chairman or by the general manager. Mr. John Cory has stated in his affidavit the general course of business at board meetings, and his cross-examination does not substantially differ from the account he there gives. Wright, J., has regarded this evidence as an admission by Mr. John Cory of a total abnegation of the use of his faculties, and of an entire neglect of his duties. We cannot go so far as this. His evidence does, however, show that he only attended, when present, to whatever his attention was called to; and that having no suspicion that anything was wrong he made no special inquiries in order to ascertain that all was right. After Mr. John Cory had ceased to be a director the company made large advances on insufficient security and took over an insolvent business which greatly embarrassed it. The company, however, was not unable to pay its debts, for its large uncalled capital was amply sufficient for that purpose, and, so far as its outside liabilities are concerned, it always has been and is quite able to discharge them in full. Being, however, in difficulties, the National Bank determined to amalgamate with another company and to wind up. An agreement was entered into between the National Bank and the Metropolitan Bank for the transfer to the Metropolitan Bank of all the assets of the National Bank (except the uncalled capital) and for the payment by the Metropolitan Bank of all the debts and liabilities of the National Bank, subject, however, to this stipulation—namely, that if the assets transferred exceeded the liabilities the excess should be returned to the National Bank, whilst if the assets transferred should prove insufficient to discharge those liabilities the deficiency should be made good by the National Bank. There is a deficiency of about £41,000, which the National Bank has to make good. The sum can be raised easily enough by a call on the shareholders; but they naturally object to this if money can be got in from other quarters which will relieve them from the necessity of paying a call. The investigation into the affairs of the National Bank which has been made in order to carry out this amalgamation with the Metropolitan Bank has revealed a very unsatisfactory state of things. The whole of the paid-up capital has been lost, and some £41,000 has to be raised to clear it from debt. The cause of loss is to a large extent attributable to the fact that a large number of debts due to the bank by its customers

have turned out to be bad ; and large sums advanced to directors and owing by them are irrecoverable. Moreover, large dividends have been paid for a number of years as if the bank was flourishing, whilst, in truth, if its affairs had been properly conducted, the large dividends declared and paid ought never to have been recommended by the directors. There can be no doubt that the shareholders were grievously deceived by the reports and Balance Sheets laid before them ; and no one can be surprised at their anger with their directors, and especially with the chairman and general manager, both of whom have been criminally prosecuted and convicted for their fraudulent conduct. Mr. John Cory's answer, however, to the attempt to make him liable for the losses sustained and dividends paid whilst he was a director is that he was himself as much deceived as the shareholders by the chairman and manager, and that he was not guilty of any breach of his duty in not making special investigation when he had no reason to suppose that anything was wrong. Wright, J., has come to the conclusion that Mr. John Cory was not only negligent, but fraudulent, or, at all events, guilty of misconduct equivalent to fraud as regards its legal consequences. The learned Judge has arrived at this conclusion from the fact that in their reports the directors unjustifiably stated that they had made provision for bad and doubtful debts, whereas they had not. That the chairman and manager knew this is very likely true, but that Mr. John Cory knew it is quite another matter. The table of bad debts shows that sums were constantly written off for bad debts, and there is nothing to justify the inference that Mr. John Cory knew that these sums were insufficient, or that he did not honestly believe them to be sufficient. It may be that he ought to have been more vigilant than he was and that he should not have trusted his brother and Collins so much as he did. But negligence is one thing, fraud is another, and we are quite unable to adopt Wright, J.'s, view that Mr. John Cory acted fraudulently in making reports to the shareholders and laying the Balance Sheets before them. At the close of the argument for the liquidator we intimated that, in our opinion, the charge of fraud against Mr. John Cory failed, and further study of the evidence has strengthened this conviction. This is not only a very important matter to him as regards character, but to a great extent it relieves him from responsibility for anything done or omitted before June 14 1889. Another part of the case on which we are unable to agree with Wright, J., relates to the date of Mr. John Cory's retirement from the board. There can be no doubt that he sent in a letter of resignation (although it was not produced), and that his resignation was accepted at a meeting of directors held in London on December 18 1890, and that he was informed of its acceptance on December 22 1890. There can also be no doubt that his resignation was concealed from the shareholders until after their meeting on January 21 1891, and that, in the report then laid before the

shareholders, the name of Mr. John Cory appeared as a director. The evidence is conflicting upon the question whether his resignation was or was not mentioned at the meeting. On the other hand, he was not present at it, he swears he did not know that his name still appeared as a director. The learned Judge says he is unable to believe that John Cory did not know that his name so appeared, and in the view of the Court below Mr. John Cory improperly allowed his retirement to be concealed and allowed himself to be held out as a continuing director and as concurring in the report of January 1891, which the learned Judge holds to be as fraudulent on Mr. John Cory's part as those which preceded it. We cannot adopt the learned Judge's view of this part of the case. We are satisfied that Mr. John Cory's resignation was *bond fide* and a fact, not a sham. He was not, in fact, a director after his resignation was accepted. He took no part in drawing up the report nor in recommending the dividend declared in January 1891. Even if he received the report before the meeting and saw his name as a director and did not insist that his name should be struck out or that his resignation should be mentioned to the meeting (and the case against him cannot be put more strongly than this), even then we fail to see how such knowledge and omission can, without more, make him liable for misapplying the funds of the company, when in truth he took no part in their misapplication. With these preliminary observations, we pass to consider Mr. John Cory's liability in respect of the dividends declared in July and December 1889 and July 1890. The liquidator has taken the view that the dividends declared and paid by the company when Mr. John Cory was a director were all paid out of the capital of the company, and the evidence adduced by the liquidator is directed to prove that such was the case. But when this evidence is examined it seems quite plain that the dividends were not in fact paid out of any part of the money forming the paid-up nominal capital of the company, but were paid, notwithstanding the loss of that capital, and without making it good. What was done was this. The accounts were made up annually. Such losses incurred during the year as the directors recognised as losses were written off or provided for by carrying sums of money over to a reserve fund, and the balance of the receipts in each year over the outgoings in the same year (after making some allowance for bad debts and deductions for sums carried over to the reserve fund) were treated as the profits of that year, and were divided as dividends. Losses written off in one year were not brought forward the next year so as to diminish the profits of that year, but were simply ignored, a fresh start being made every year and dividends being divided out of the excess of the annual receipts over the annual expenses. The effect of this was to throw all bad debts written off, and not provided for by an increase of reserve fund, on the capital and to diminish the paid-up capital year by year, and nevertheless to keep

paying dividends out of the excess of the annual receipts over the annual expenses. It is obvious that this method of procedure, if long continued, would ultimately exhaust the paid-up capital of the company, and the first disastrous year in which the current outgoings exceeded the current incomings would produce great embarrassments. Such a mode of dealing with the company's assets, however reprehensible, must nevertheless not be confounded with paying dividends out of the paid-up capital of the company. The paid-up capital of a limited company cannot be lawfully returned to the shareholders under the guise of dividends or otherwise. Even an article of association authorising the payment of interest to shareholders on the amounts paid upon their shares cannot authorise a payment of such interest out of capital. See *Masonic, &c., Co. v. Sharpe* (1892, 1 Ch. 154). But paid-up capital which is lost can no more be applied in paying dividends than in paying debts. Its loss renders any subsequent application of it impossible. There was no such dealing with the paid-up capital of the company in this case as to amount to an illegal application of it. Further, it is not possible for the Court to say that the law prohibits a limited company, even a limited banking company, from paying dividends unless its paid-up capital is intact. Suppose a heavy unexpected loss is sustained. It must be met if there are assets to meet it with. The capital, even uncalled capital, must, if necessary, be applied to meet it. Such an application of capital is a perfectly legitimate use of it. There is no law which in the case supposed prevents the payment of all future dividends until all the capital so expended is made good. Many honest and prudent men of business would replace a large loss of capital by degrees and reduce the dividends, but not stop them entirely, until the whole loss was made good. No law compels them to pay none at all. There are cases in which no honest competent man of business would think of charging particular debts or expenses to capital. We are certainly not prepared to sanction the notion that all debts incurred in carrying on a business can be properly permanently charged to capital, and that the excess of receipts over the other outgoings can be afterwards properly divided as profit, as if there had been no previous loss. No honest competent man engaged in trade or commerce would carry on business on such a principle. But excluding cases in which everyone can see that a particular debt or outlay cannot be reasonably charged to capital, it may be safely said that what losses can be properly charged to capital and what to income is a matter for business men to determine, and is often a matter on which opinions of honest and competent men differ. See *Gregory v. Patchett* (33 Beav. 595). There is no hard and fast legal rule on the subject. There can, however, be no doubt that if expenses or payments are obviously improperly charged to capital, and are so charged simply to swell the apparent profits and to make it appear that dividends may be properly

declared, dividends declared and paid under such circumstances cannot be treated as legitimately paid out of profits, and can no more be justified than if they were paid out of capital. This was determined in *Bloxam v. The Metropolitan Railway Company* (L.R. 3 Ch. 337, 350), and has been acted upon in many other cases—e.g., *Rance's case* (L.R. 6 Ch. 104); *In re The Oxford Benefit Building Society* (35 Ch.D. 502); *The Leeds Estate Company v. Shepherd* (36 Ch.D. 787); *In re The London and General Bank* (1895, 2 Ch. 673, 686). It would seem that Sir G. Jessel inclined to the opinion that a limited company could not pay dividends unless its paid-up capital was kept up. See *In re The Ebbw Vale, &c., Company* (4 Ch.D. 827). But no decision has yet gone this length, and it has since been decided that dividends may be paid, even by a limited company, although its nominal capital is not kept up. See *Verner v. General and Commercial Investment Trust* (1894, 3 Ch. 239), and the earlier case *Lee v. Neuchatel Asphalte Company* (41 Ch.D. 1). What was lost there was fixed capital, and it is obvious that circulating capital or any other money employed in earning returns must be deducted from them in order to ascertain how much of them can be regarded as profit. If the returns do not exceed the money spent in procuring them (whether that money be called circulating capital or any other name) there can be no profits, and no ingenious process of bookkeeping can alter the fact. It is not denied in this case that the annual receipts did exceed the annual outgoings, and the dividends having been paid out of the excess, the allegation that they were paid out of capital is not accurate. But, as already pointed out, it does not at all follow that the course adopted by the directors, in declaring dividends year after year as they did, was legally justifiable. It cannot be denied that the Balance Sheets and Profit and Loss Accounts concealed the truth (as now known) from the shareholders, and were, as it now turns out, grievously misleading. The shareholders were never told that the paid-up capital was being constantly diminished by bad debts, as now appears to have been the case. The shareholders were told every year that proper provision was made for those debts, and now that the case has been thoroughly investigated it is really reduced to the question whether Mr. John Cory was justified in making the statements he did and in dealing as he did with debts which have now been ascertained to be bad. It is easy to be wise after the event, and there is danger in treating a director as knowing years ago what now appears to be the fact. But it is the duty of the Court to examine the state of things as they appeared to him when the dividends were declared, and to determine whether he was justified in what he did by what he knew and ought to have known. What he ought to have known is as important as what he knew. It was stated in a judgment delivered in this Court a few weeks ago in the *Lagunas* case (reported in *The Times* of June 27 last) that if directors act within their powers,

if they act with such care as is reasonably to be expected from them having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge their equitable as well as their legal duty to that company. We believe this statement of the law to be correct, and we adopt it as our guide. It has been shown that in this case the dividends did not, in fact, come out of the paid-up capital of the company. Fraud is not established against Mr. John Cory, nor is there any proof that he was acting in the interests of his own friends or of himself and not *bond fide* with a view to the interest of the National Bank. The inquiry, therefore, so far as he is concerned, is reduced to the representations he made as to the position of the company and of his alleged want of care and attention to the affairs of the bank, and more particularly to his omission to find out that the manager was misleading the directors. In the *Lagunas* case it was said, and we repeat, that the amount of care to be taken is difficult to define; but it is plain that directors are not liable for all the mistakes they may make, although if they had taken more care they might have avoided them. See *Overend, Gurney & Co. v. Gibb* (L.R. 5 H.L. 580). Their negligence must be not the omission to take all possible care; it must be much more blameable than that; it must be in a business sense culpable or gross. We do not know how better to describe it. Some useful observations justifying the expression "gross negligence" will be found in Lord Chelmsford's judgment in *Giblin v. McMullen* (L.R. 2 Privy Council 336). It is not, however, necessary to enlarge on this subject. The care which in any case can be reasonably expected to be taken is, speaking generally, the measure of the care which the law requires to be taken where there is no contract affecting the question. What we have to determine is whether Mr. John Cory was justified in making the statements he made, and whether he could be reasonably expected to find out more than he in fact knew. Bad and doubtful debts were constantly considered and provided for; some being written off; some by setting aside reserve capital; £12,000 odd were written off before 1890, and £13,600, or thereabouts, were written off in that year, and £70,000 was set aside for reserve capital. Such matters were considered by the directors. The accusation is that they did not do enough in this way. But here, again, even if some debts known to the manager to be bad were treated as good, it is not proved that Mr. John Cory knew this or had reason to suspect that what was done was inadequate. His evidence is clear that he neither knew nor suspected that such was the case, and that he really believed that the provision was ample. The same question arises, Was it his duty to test the accuracy or completeness of what he was told by the general manager and managing director? This is a question on which opinions may differ, but we are not prepared to say that he failed in his legal duty. Business cannot be carried on on principles of distrust.

Men in responsible position must be trusted by those above them as well as by those below them until there is reason to distrust them. We agree that care and prudence do not involve distrust, but for a director acting honestly himself to be held legally liable for negligence in trusting the officers under him not to conceal from him what they ought to report to him appears to us to be laying too heavy a burden on honest business men. But this is the whole of Mr. John Cory's shortcoming as proved by the evidence. Even his letter of January 19 1888, on which Wright, J., placed so much stress, ceases to turn the case against him if he honestly believed it to be true and if he was justified as a reasonably careful man in so believing; and we cannot say that he was not. Cases such as these are always cases of degree. In *Leeds Estate Company v. Shepherd* (36 Ch.D. 788) the directors trusted their manager and were held liable. They did not take the trouble to see that what he did was even apparently what he ought to have done. They delegated their functions to him. The case of *In re Denham & Co.* (25 Ch.D. 752) is more like the present, and there the director was held not liable. It must be now conceded that if Mr. John Cory had himself studied the weekly statements and quarterly returns and had compared those for one period with those for another, and more especially if he had seen the letters addressed by the auditors to the directors, he would have been put upon inquiry, and would have found out, if he had not neglected his duty, that the affairs of the bank were not in the flourishing condition which he believed them to be in. The existence of the letters written by the auditors and accompanying their certificates were very much relied on against Mr. John Cory. Those letters are not produced. They were never found by the liquidator. His knowledge of them is derived from copies furnished by the auditors. These letters warned the directors annually, in and after 1884, and especially in January 1890, that there were matters which required investigation, and if Mr. John Cory had known or suspected that there were such letters, and he had omitted to make inquiries into the matters to which attention was drawn, he would plainly have neglected his duty as a director and have been guilty of negligence to the degree justifying the epithet "gross." But he had no reason to suppose there were any such letters, and apart from them the auditors' reports justified him in supposing that all was right. The letter from the auditors of January 13 1890 to the secretary of the bank was answered by the secretary on February 13 1890; it had been laid before the board, and this was done on the 10th. But Mr. John Cory was not there. He was apparently present at a subsequent meeting at which the minutes of the meeting on the 10th were confirmed, but the matter did not attract his attention; and, considering the terms of the minutes, this was very natural. We are satisfied that these letters from the auditors were fraudulently concealed from Mr. John Cory, and that he never knew of, or suspected,

their existence. His ignorance of them was not attributable to negligence on his part. Mr. John Cory's omission to examine the weekly statements and quarterly returns is also, we think, excusable, although not on the same grounds, for they were known by him to exist, and were in the board room for inspection. We have had the advantage of an exhaustive examination of them, and of a comparison of long series of them, and we know the result and their full significance. But without a comparison of those for one period with those of an earlier period a director would derive little information that was really useful. No suspicion being aroused, Mr. John Cory's reasons for not examining them are natural, and his omission to examine them does not show want of reasonable care and attention on his part to the affairs of the bank. He had no reason to suppose that there were unsatisfactory debts beyond those written off and provided for. The evidence when carefully sifted unquestionably shows that Mr. John Cory might have found out that he was deceived by the general manager, and that the dividends declared were not in a business sense warranted by the profit made. On the other hand, the evidence shows that although he was deceived he neither knew nor suspected it. We are not prepared to say that he is guilty of any breach of duty in not discovering that those whom he trusted were misleading him; nor that in point of law he was guilty of any breach of duty in recommending the payment of dividends as and when he did. A director does not warrant the truth of his statements; he is not an insurer. But if he makes misstatements to his shareholders he is liable for the consequences unless he can show that he made them honestly, believing them to be true, and took such care to ascertain the truth as was reasonable at the time. This, we think, Mr. John Cory did. It follows that Mr. John Cory is not only not liable to make good the dividends declared, but also that he is not liable to refund those which he himself received as a shareholder, whether before or after June 14 1889, for there was no breach of trust in this matter by him. His conduct before that date was not more remiss than it was afterwards. As regards the advances made to directors without security between June 14 1889 and December 18 1890. The lien given by Article 15 came into existence automatically and gave the company an equitable charge on the shares with a power of sale, which is very important. It certainly constituted a security (*The General Exchange Bank*, L.R. 6 Ch. 818, p. 821). Article 98 enumerates what the board may do, and presupposes consideration and attention by them; and we are of opinion that no credit was to be given and no advance was to be made to a director without deliberation by the board nor without security, and if so made it would be difficult to justify the advance by falling back on the lien conferred by Article 15. But we cannot go the length of saying that shares in the bank might not be accepted as security on reasonable deliberation if of adequate value. We

do not overlook the fact that their value depends on the value of the assets of the company lending its money on them. This renders care and deliberation all the more necessary whenever the borrower was a shareholder or a director. But in either case we are of opinion that shares in the bank might be accepted as security if the board considered them sufficient as regards value. Suppose the board considered a proposed advance, and, being satisfied that the shares would sell for considerably more than the sum advanced, authorised an advance and obtained a deposit of the share certificates of the borrower as security. We do not think they would have failed in their duty, even if the borrower were a director. This being so, we cannot hold the board liable in point of law for omitting to obtain the certificates; for their lien and power of sale under Article 15 would not be defeated by the absence of the certificates, and we do not understand that any loss has been sustained by the bank by reason of the absence of certificates. In substance, therefore, we agree with the view of Wright, J., on this point. Now let us see what was done by Mr. John Cory. Large advances were made to some directors in 1889 and 1890. We leave out of account the advances made in 1891, as Mr. John Cory was not then a director. We also pass over the errors in figures which Mr. Norris has pointed out. It is proved that in 1889 and 1890 Mr. Crawshay, one of the directors, was constantly allowed to overdraw. The branch manager at Bridgend perpetually drew attention to this and wrote for instructions, but apparently got none. Crawshay was a large shareholder in the company, and the market value of his shares exceeded his advances and overdrafts. Other deeds and documents were apparently also held by the board as a security. Other similar cases are given by the liquidator where these advances and overdrafts have resulted in large losses. The directors clearly regarded the lien as a security, and a "Stop Share" Book was accordingly ordered to be kept in 1884, in which all shareholders' overdrafts were to be entered. There is no proof that if the shares could in point of law be taken as security, they were insufficient at the time they were taken. The securities were never reported to the board as insufficient; nor did Mr. John Cory know or suspect they were so. His cross-examination on these matters shows that many very material facts were concealed from him—*e.g.*, the fact that a director was a partner in a borrowing firm; the amounts to which some of the directors obtained advances or were indebted to the bank; the insufficiency of the securities. Moreover, several of the advances which have resulted in loss were not sanctioned by him, and were made without his knowledge. The question, of course, again arises whether Mr. John Cory ought not to have been more vigilant. The observations already made on this head need not be repeated. Nor is it necessary to examine in detail his liability for other improper advances. Here, again, his answer is the same, and his liability depends on his

omission to find out the facts. His liability for such omission has been already considered and negatived. Having arrived at the above conclusions, it is unnecessary to decide whether Mr. J. Cory's counsel were right in their contention that, assuming Mr. J. Cory to be liable to make good the dividends declared whilst he was a director, the liquidator, as representing the shareholders in the bank, could not have recovered such dividends from him. The argument was that all moneys recovered by the liquidator would have to be distributed amongst the shareholders, who had already had the benefit of the dividends improperly declared, so that they would in effect be paid twice over. In the course of the argument it was pointed out that the money sought to be recovered was, if recoverable, an asset of the company, and that the liquidator was the person to get it in, and that *Turquand v. Marshall* had no application to claims by incorporated companies. We pointed out that the money which had been divided in years gone by had been paid and received as profits, and not as capital, and Mr. J. Cory could not treat the shareholders, whom on the present assumption he would have misled, as having received the dividends as capital. We said that we agreed with Cotton, L.J.'s, observations in *Flitcroft's* case, as we understood them, viz., the Court could and would prevent the liquidator from taking any proceedings which were useless and vexatious, but that this proceeding in the case supposed would be neither the one nor the other. On this part of the case we agreed with Wright, J. Lastly, we think it only due to the liquidator to add that, although Mr. J. Cory has succeeded in his appeal, his conduct justified the closest scrutiny. But the order appealed from ought to be reversed, and, having regard to the serious charges made against him, the liquidator must pay Mr. J. Cory his costs both of the summons and of his appeal.

The case of THOMAS *v.* THE CORPORATION OF DEVONPORT.

(Decided before the LORD CHIEF JUSTICE, A. L. SMITH, and
VAUGHAN WILLIAMS, L.JJ., on 2nd November 1899.)

Elective Auditors—Remuneration.

In this case the plaintiff is the elective auditor of the defendant corporation, and is also designated by statute as the auditor of the urban sanitary authority. He claimed remuneration as elective auditor out of the borough fund, and he also claimed remuneration for twenty-three and a-half days' work as urban sanitary auditor during a number of years past at the rate of two guineas a day. Phillimore, J., who tried the action, held that the plaintiff was not entitled to any remuneration

as elective auditor, and with regard to his work as the auditor of the urban sanitary authority said the plaintiff was barred by the Statute of Limitations with respect to some of the days claimed for, and he had taken longer than was necessary to do the work in the later period for which he claimed. The learned Judge held that £34 paid into Court by the defendants in respect of sixteen days' work during the past two years was sufficient remuneration for the plaintiff's services as auditor of the urban sanitary authority, and therefore gave judgment for the defendant corporation on both issues. Hence the plaintiff's appeal.

JUDGMENT.

The Lord Chief Justice, in giving judgment, said this was one of those cases under the statute in which the corporation was also the urban sanitary authority. The case really would have been unarguable on the part of the plaintiff if it had not been for some observations made by Phillimore, J., in delivering judgment. As regarded the claim in respect of auditing the corporation accounts as such it was quite clear that there was not a shadow of ground for saying that the plaintiff as elective auditor had any claim at all. The receipts of the corporation as such were brought into and formed part of the borough fund, and payments of all accounts legally made by the corporation must be paid out of that borough fund. Parliament had in clear and distinct terms laid down the appropriations which might be made out of the borough fund in the statute regulating the matter. If the plaintiff had been a servant of the corporation there was ample power given to the corporation to pay him out of the borough fund in respect of any services which he rendered. But he was not a servant of the corporation. He was elected by the burgesses of the borough under a statute giving the burgesses power to elect an auditor. There was no claim in respect of such services. As regarded his services as auditor of the urban sanitary authority, he was entitled to be compensated at a rate of not less than two guineas for every day on which he was properly employed on the work. If the matter had simply rested there, there would have been an end of it, and it would not have been possible for this Court to have reviewed the judgment of the learned Judge of the Court below, because he found as a fact that four days in each half-year—or eight legal days in each year—was ample for the work which the plaintiff did. Unfortunately, as he (the Lord Chief Justice) thought, Phillimore, J., had used some language which suggested too narrow a judgment of what the proper duties of the auditor of the urban sanitary authority were. He (the Lord Chief Justice) did not subscribe to the doctrine that the auditor's sole duty was to see whether there were vouchers, formal and regular, justifying each of the items in respect of which the authority sought to get credit upon the accounts. That was an incomplete and

imperfect view of the duties of such an auditor. Such an auditor was not only entitled, but justified and bound, to go further than that. He should make a fair and reasonable examination of the accounts, and see whether there might not be, amongst the payments made, payments which were not authorised or which were illegally made, and if he so discovered such payments it would be his duty certainly to make them public, certainly to report them to the authority itself, and certainly to report them to the burgesses, who had created that authority. But granting all that, he (the Lord Chief Justice) saw no reason for believing that eight days would not be adequate in which to do the work, and he saw no reason for disturbing the judgment of the Court below.

Smith and Williams, L.JJ., said they entirely concurred, and the appeal was accordingly dismissed with costs.

The case of MOXHAM AND OTHERS *v.* GRANT.

(Decided before A. L. SMITH, COLLINS, and VAUGHAN WILLIAMS, L.JJ., in the Court of Appeal, on the 15th November 1899.)

Company—Director—Payment to Shareholders out of Capital—Liability of Shareholders to repay.

This was an appeal from the judgment of the Divisional Court (Lawrence and Channell, JJ.) reported in 15 *The Times* L.R. 180; (1899) 1 Q.B. 480. The plaintiffs were directors of a company named Cory's Steamers, Lim. The company owned a steamship named the *Primrose*, which was lost in 1894. The underwriters paid £719 2s. 6d. in respect of the loss. That sum represented capital, as it represented the steamship. In April 1894 the directors sent a circular to the shareholders in the following form:—"We have a sum of money in hand from insurance received on account of the loss of the *Primrose*. We propose remitting 10s. per share. If you see no objection, we will send you £—, being 10s. on your — shares, on your sending a receipt on enclosed form, and provided all the shareholders consent. There will be a considerable sum more to receive for insurance of *Primrose*." The form of receipt was as follows:—"Received of Cory's Steamers, Lim., the sum of £—, being a reduction of 10s. per share on the — shares held by me." In reply to the circular the defendant sent the following letter:—"I quite agree with the proposition of your letter of April 10, and enclose my receipt for £13, being 10s. on my 26 shares." Other similar payments were made to the defendant, the total amount being £35 15s. Upon December 29 1896 a winding-up order was made

against the company, and on December 22 1897 the liquidator of the company obtained an order under section 10 of the Companies (Winding-up) Act 1890, declaring that the payment to the defendant and other shareholders of the various sums, amounting in the whole to £719 2s. 6d., was a payment of part of the capital of the company and was unlawfully and improperly paid in reduction of the capital of the company, and it was further ordered that the directors should pay to the official liquidator the sum of £719 2s. 6d. The order was expressly made without prejudice to the right of the directors to be recouped by the shareholders the amounts paid by the directors to them. The directors, the plaintiffs, then brought an action against the defendant to recover the £35 15s. they had paid to him. The County Court Judge gave judgment for the plaintiffs, and the Divisional Court affirmed the decision. The defendant appealed.

JUDGMENT.

The Court dismissed the appeal.

Smith, L.J., said that it was admitted that the £719 2s. 6d., which was paid by the underwriters on the loss of the *Primrose*, was part of the capital of the company. The directors and shareholders agreed that they did not want this money as capital and resolved to divide it. Therefore the shareholders knew that it was part of the capital of the company. It was not a case where shareholders received money of the company in ignorance that they had no right to receive it. There was no order of the Court obtained for the reduction of the capital of the company. When the company was wound up the liquidator discovered what had been done, and, in his Lordship's opinion, the liquidator might have taken proceedings against everyone who had received portions of the £719 2s. 6d. Instead of doing that, the liquidator, as the most convenient course, took proceedings against the directors who had received the money and who had distributed it among the shareholders, and he recovered the whole amount from them. The directors thereupon brought an action against the defendant to recover from him the amount which he had received, and which the directors had been compelled to pay to the liquidator. What was the position of a shareholder who had received money of the company with notice that it formed part of the company's capital? It seemed to his Lordship that the position of the shareholder in such a case was, as laid down by Sir George Jessel in *Russell v. Wakefield Waterworks Company* (L.R. 20 Eq. 474, at p. 479), that of a constructive trustee. That being so, the rule of equity as between two trustees had been explained in many cases, and in *Chillingworth v. Chambers* (1896, 1 Ch. 685) the matter was fully discussed by Lindley and Kay, L.JJ., and himself, and he would only refer to one passage in his own

judgment (at p. 707):—"As between two trustees who are *in pari delicto*, the one who has made good a loss occasioned by a breach of trust for which the two are jointly and severally liable may obtain contribution to that loss from the other." The case cited in support of the proposition was *Lingard v. Bromley* (1 V. and B. 114) (see p. 710 of the report). In the present case the defendant took his portion of the £719 2s. 6d. with notice that it formed part of the capital of the company. He became a constructive trustee, and must recoup his co-trustees, who had been compelled to pay it back, the amount so received by him. Upon that ground the judgment of the Divisional Court was right. His Lordship also thought that the doctrine laid down in *Bonner v. Tottenham Building Society* (1899, 1 Q.B. 161) applied. He desired to add that the passage in "Lindley on Companies" (5th ed., pp. 389, 390) did not apply where the shareholders took the money with notice, as here, nor where one person had been compelled by process of law to pay in relief of another.

Collins, L.J., concurred. When the circumstances of the case were understood, it was clear that the liquidator could have enforced against each shareholder repayment of the moneys received by each. That he could enforce repayment against the directors to whom the whole fund had originally passed lay at the root of the matter. Therefore they began the discussion with these facts. The directors, being the persons who had collected and distributed the fund, were liable to repay it to the liquidator, and the persons to whom it was distributed were also liable to the liquidator, and the directors were compelled to pay the whole sum distributed. Further, that payment had necessarily gone in relief of the shareholders. Upon those facts—namely, a payment by compulsion by one of a sum for which another was liable to the same person—there arose by implication of law a right in the person paying to be recouped by the person relieved. Having got those facts, which entitled a person so paying to indemnity or contribution, what was the answer attempted to be set up? The only possible answer was that these persons were joint tortfeasors, and that there was no right of indemnity or contribution. Lord Denham, in *Betts v. Gibbins* (2 A. and E. 57, at p. 74), in dealing with *Merryweather v. Nixon* (8 T.R. 186), said that that case "seems to me to have been strained beyond what the decision will bear. The present case is an exception to the general rule. The general rule is that between wrongdoers there is neither indemnity nor contribution: the exception is where the act is not clearly illegal in itself." He (the Lord Justice) did not suppose that any of those who dealt with this money thought that there was any illegality in doing what was done. The only illegality was a technical one; it was an *ultra vires* act. It had been held over and over again that money paid in breach of trust to persons who took it

knowing the payment to be a breach of trust did not constitute those persons joint tortfeasors. Channell, J., dealt with that point and with the line of authorities relating to it; and Vice-Chancellor Bacon, in *Flitcroft's* case (21 Ch.D. 519, at p. 527), also so held. That disposed of the case. But he (the Lord Justice) would deal with the argument whether or not there was a trust. The only bearing this had lay in establishing that the person who received the money received it in such circumstances as made it capable of being recovered back. If the money was paid to the shareholder unearmarked, so that the liquidator could not claim it as money had and received to his use, the chain of consecution out of which the right to indemnity arose was broken. Unless the payment was made in relief of the person against whom the indemnity was claimed, the claim for indemnity was gone. Therefore, it must be shown that the liquidator would be entitled to sue the shareholder. That was established if the liquidator could follow the money, and that was so in the present case, because the shareholder received it with notice, from which, if he knew his law, he must have known that the directors had no right to pay it to him. The whole chain, therefore, was established. The payment by the directors to the liquidator was in relief of an existing liability of the shareholders, and was a payment which they were compelled to make. Therefore there arose upon common law principles a right of indemnity. There was also the same right on the general rules of equity, and this right was not affected by any question of the parties being joint tortfeasors.

Vaughan Williams, L.J., delivered judgment to the same effect.

The case of THE IRISH WOOLLEN COMPANY, LIM. v. TYSON
AND OTHERS.

(Decided before the LORD CHANCELLOR, and HOLMES and FITZGIBBON,
L.JJ., in the Irish Court of Appeal, on the 20th January 1900.)

*Falsification of Books—Liability of Auditors—Payment of Dividends out
of Capital.*

On Friday, in the Court of Appeal, judgment was delivered on the appeal by Mr. Edward Kevans, Chartered Accountant, 22 Dame Street, Dublin (one of the defendants) against the decision given by the Master of the Rolls, reported in 25 *Accountant Law Reports*, p. 89. The question before the Court was simply whether Mr. Kevans was, or was not, responsible for the non-detection of the frauds.

Serjeant Dodd and Mr. C. O'Connor, Q.C. (instructed by Mr. Richard Davoren), appeared for the appellant.

The Right Hon. The MacDermot, Q.C., and Messrs. Wright, Q.C., Blood, Q.C., and W. F. O'Rourke (instructed by Messrs. William Findlater & Co.) appeared for the respondents.

Lord Justice Holmes, in delivering his judgment, referred to the career of the company, which, he said, was formed in June 1887, for the purpose of promoting the woollen industry in Ireland, the original capital being £6,000. For some time at the commencement the business was almost entirely confined to the purchase of woollen goods from Irish manufacturers. In the year 1889 the directors resolved to develop their undertaking by seeking to establish their home trade, and for this purpose they increased their capital. The prospectus announcing this resolution alluded to the success that had attended the operations of the company up to that time, and held out more brilliant prospects for the future. The whole of the additional capital, however, was required to pay off debts previously incurred, and could hardly be used for the purpose of opening up new business. Between the years 1888 to 1895, nine Balance Sheets were presented to the shareholders, each showing considerable net profits; and during all this period dividends were paid which never once fell as low as 5 per cent., amounting to £4,649. There is not the slightest evidence of the soundness of the financial position of the company until its operations were suspended, when Mr. Carnegie—the auditor's representative, who was examining the accounts—noticed a double entry. The mistake was a trifling one, and he was satisfied with the explanation given by Mr. Crawford, who had been for some time the accountant of the company. Crawford and Johnston abandoned their positions, and the Balance Sheet for the last period (1895) showed a deficiency of £11,107. The company, by order of the Court, was directed to be wound up compulsorily, and Mr. Garde—who was himself formerly in the employment of the defendant auditor—found that, although the company was just solvent as regards its creditors, its capital had entirely disappeared, and I presume it was his report that led to the bringing of the present action. It appears that Crawford, acting either by himself or with Johnston, the warehouseman, was a defaulter to a very large extent. Mr. Kevans says, in his letters of the 22nd and 24th of January 1896, "that although the whole of the items that made up Crawford's deficiency were apparently received within the three months ending 31st December 1895, it is highly improbable that he could have abstracted all that money in so short a period of time, but that it was impossible to say how far back exactly the defalcations extended." The defendant was held guilty in connection with Crawford's fraud, and I therefore pass away from this portion of the case, which relates to only a small part of the losses sustained by the company. To account for the rest it is necessary to go more fully into the way the

business was carried on. The directors, who were paid no fees for the first two or three years, were originally selected by lot; and Mr. Peter White was appointed managing director; Mr. Tyson was appointed secretary at £250 per annum; and the rest of the staff—examiner and packer—at £150 and £75 per annum respectively. Mr. Tyson did not long remain secretary, and was succeeded by Mr. McDonough, and subsequently by Crawford. Mr. White, in one of his letters, referred in a somewhat gloomy manner to the large annual amount of money paid to the officers in the shape of salaries, and recommended such a change being made as would reduce the annual expenses to £600. White's recommendation was accepted, and from that date Crawford was appointed secretary. He only received 35s. per week, and his income from the company never seemed to come up to £150 a year. I presume that Johnston did not receive more. Mr. Kevans was the first auditor of the company, and he provided the books which, in his judgment, were necessary for keeping the accounts. They consisted of:—1. Cash Book; 2. Customers' Ledger; 3. Creditors' Ledger; 4. Day Book; 5. Invoice Guard Book; 6. Petty Cash Book. It cannot be denied that these were sufficient to show the true financial position of the business of the company, if they had been honestly kept. The MacDermot commented upon the absence of one book, but I attach no importance to this. The multiplication of books, if written up by different parties, may be a check upon fraud, but in this case all the bookkeeping was done by a single officer who, if dishonest, would take care to make the books appear perfectly straight. There was another book, referred to in the evidence, kept for the private use of the directors, but whatever its significance may be it could not affect Mr. Kevans. In February 1891 there occurred a circumstance materially bearing upon the case. After that time the auditor's fee was increased to £40, the consideration being a "monthly audit." It was not understood by this that a Balance Sheet, or Profit and Loss Account, was to be prepared for each month, or that a monthly statement was to be submitted to the directors. It was a monthly investigation for the purpose of checking fraud or error. It was, as Mr. Kevans himself says, "a system of monthly checking with a view to the half-yearly audit." Mr. Kevans seems to have done little of the actual work himself, and the evidence varies as to the nature of the supervision which he gave to it; the investigation of the books he deputed to his assistants—namely, Mr. Roche, Mr. Garde, and Mr. Carnegie, and it must be on the faith of their representations that he certified the Balance Sheets. I presume this course is not unusual, and that an accountant with a large business is not supposed to do everything himself. The auditor is bound to give reasonable care and skill, but this can also be exercised by his deputy. I do not think there is anything to be gained by considering in the abstract the duties of an

auditor of a joint stock company. He is entitled to see the company's books and the materials for their books, and also to ask for explanations. But he is not called on to seek for knowledge outside the company, or to communicate with customers or creditors. He is not an insurer against fraud or error; and if fraud is alleged it must be shown with precision the acts of negligence for which he is said to be responsible. Nine Balance Sheets were prepared, and the figures on some represent the aggregate amount of many items, but I propose to deal only with matters that have been referred to during the hearing. There are three sets of figures with which I will deal:—(1) Stock-in-trade; (2) sundry debtors; (3) sundry creditors on the liability side of the Balance Sheet. Taking these in order, I find that Mr. Garde, in his evidence, drew a distinction between the home stock and the stock in America, which was never mentioned in this Court. I do not fully understand this, as Mr. Kevans can only be held responsible from the 4th of January 1892, and at that date the American trade had been abandoned. The Master of the Rolls expressed a doubt, with which I agree, as to whether it was the duty of the directors to take stock with their own hands. It was taken by Mr. O'Callaghan, and I agree with the Master of the Rolls that he (Mr. O'Callaghan) did quite as much as he could be expected to do. There was certainly no duty cast on the auditor to take stock. What he did was to have the calculations checked in his office, and this was done with proper care. Mr. Kevans said he was particularly careful as to the deduction for discount, and, as far as I could gather, the universal rate of 10 per cent. seems reasonable. Moreover, an auditor has nothing to do with the terms upon which the company, or a trader, buys or sells. As to No. 2, the charge in this is that the allowance made for the trade discount of $2\frac{1}{2}$ per cent. was omitted. This is a purely technical question. Mr. Kevans says that the proper method of dealing with these debts was to return them as they stood in the books, and to bring the discount, when it was allowed, to the Profit and Loss Account. Mr. Pixley said it would not be scientifically correct to deduct these discounts. This seems to be in accordance with common sense, and it is to be noted that although Mr. Garde, as liquidator, corrected the Balance Sheets by marking off these discounts, he never thought of doing so when conducting the audit. As to the provision for the "bad debts," if there is any one thing upon which an auditor is dependent upon the officers it is the writing off, or the making of a prospective allowance for, bad debts. He has no personal knowledge of the customers, and Mr. Kevans seems to have taken particular attention in reference to this. (See questions 2,125 to 2,127 in the evidence.) He said "he had some special knowledge on the subject, that he saw all ascertained bad debts duly written off, and that there was a fund amounting to £500 as a provision therefor." For the foregoing reasons there is no ground for

alleging negligence against Mr. Kevans on the "assets side" of the Balance Sheet. As far as this portion is concerned, I think the Balance Sheets were properly and carefully prepared, and there was nothing dishonest or negligent on the part of anyone; but if there was, it was not on the part of Mr. Kevans or of his representative. Now, dealing with "sundry creditors"; here evidently there is a fraud, and a curious thing is that no one seemed to have derived any benefit from the fraud. Dealing with the invoices, the learned Judge detailed the practice in connection with the statements of accounts being laid before the meeting, and said, the Ledger was used for the purchases made and for the payments on account thereof. If, then, all this were rightly done it would be easy for the auditor to ascertain the amounts due to the creditors, but unfortunately the books were not correctly kept. The creditors' accounts in the Ledger did not show all the goods purchased up to the time of the audit, nor could the auditor discover the omissions on account of many of the invoices being either "suppressed" or not put into the book until at a later date—a process described as "carrying over." There is some doubt as to whether the deficiency arose from the suppression or the carrying over, but my impression is that the whole of it comes within the last-mentioned class, for at the end of 1894 we find they amounted to £4,095. Mr. Peter White is now dead, and he should not be condemned unheard, but it is difficult to believe that this system was not within his own knowledge. As chief promoter he was no doubt anxious to see that the company was successful; Crawford, who was the secretary, appears to have continued the process. It seems strange that a system of fraud so long continued, and for so extensive a period, was never detected by the auditor. Once or twice he noticed something, and the explanation that was given was "that the goods were not taken into stock." The question is, was it negligent not to have seen this? There is no doubt that both the suppression and carrying over of invoices would have been detected if the auditor had called for the creditors' statements of accounts upon which payment was ordered, and compared them with the Ledger. I should have thought this was part of the auditor's duty for many reasons; but all the accountants examined, except Mr. Southworth, stated that this course is never taken unless there is something to arouse suspicion. Mr. Pixley, the eminent London accountant, says it could not well be done except in the case of a very small concern. In the face of such evidence I should not leave myself at liberty to hold that Mr. Kevans' assistants were guilty of negligence in not looking at these statements of account if they were engaged in an ordinary audit. Little time is allowed for doing so; but in this case there was this system of monthly checking. From the time that Crawford was accountant in 1890 the accounts of the company were completely in his hands. Now, White for the two years following may have given

general directions, but he was often away in America for months at a time, and it is clear that the monthly audit was instituted for the purpose of seeing that he (Crawford) would do his work regularly and honestly. I am unable to conceive how, if there was nothing wrong about this monthly checking, it did not lead at an early period to the detection of the frauds in this Ledger. Mr. Kevans ought to have found out, by the accounts, the payments that were made—and no better means could be adopted than that of a comparison with the statements of accounts. It ought to have been done in some way, and, if it had, detection would have been certain. I do not base my decision on this alone; apart altogether from the statements of account and the monthly check, I do not understand how the carrying over of the invoices could have escaped detection by the accountant, who should have used due care and skill and who was not a mere machine. The invoices carried over were ultimately posted to the Ledger. If they were posted to their true dates, it would be at once apparent that they were not entered in at the proper time. If they were posted under false dates, why was this not detected when the Ledger Accounts were checked with the invoices? and when no invoices came into the books, it is admitted that this ought to have excited suspicion. For these reasons I am of opinion that if due care and skill had been exercised, the carrying over and the suppression of invoices would have been discovered, and the auditor is liable for any damage the company has sustained from the understatement of liabilities in the Balance Sheet due to this cause since January 4 1892. I consider that not only are Mr. Kevans and his assistants not free from blame for this, but also for the mechanical way the audit was carried out. I desire to say that, although I have carefully read the evidence, I have not attempted to examine the books of the company out of Court. I, at one time, thought of doing so, but, on consideration, feared that they might lead me into error. That some damage has been sustained by the company is clear; and it will be observed that I have said nothing about the measure of the damages. Theoretically, damage resulting from negligence has been assessed in money, but it would be premature to consider it now.

Lord Justice Fitzgibbon: I entirely concur with the judgment that Lord Justice Holmes has delivered, and there are a few matters on which I desire to offer some independent observations:—

First.—What is the measure of the defendant auditor's duty in a case such as this?

Second.—What is the evidence of the particular case of the breach of that duty?

Third.—A few words upon the question of damages.

As regards the measure of the duty of a gentleman employed, as Mr. Kevans was in this case, the result is the same, as it occurs to me, in all cases in which professional skill is employed, except one, the peculiar instance of a barrister. The measure of duty is the bringing of reasonable care and skill to the performance of the business directed to be done, having regard, first to the contract of employment, then to the character of the business itself, to the remuneration of the defendant, and to all the other circumstances of the case. In strict rule, however, the measure of the duty is to be ascertained by applying to all the circumstances of the case the best consideration, so as to ascertain what ought to have been done under the circumstances. Now, in all the three English cases, and also in this case, the auditor was bound by the articles of association of the company. In one English case it was put forward for the auditor that he had never seen the articles of association, and it was admitted that he had never read them, but, nevertheless, it was held that if he did not see them, he was at least bound to do all that was required just as if he had seen them. In this case Rules 150 and 157 of the articles of association prescribe the duties of the auditor, and it is not suggested that Mr. Kevans did not see them. "Once, at least, in every year the accounts of the company shall be examined, and the correctness of the statement and Balance Sheet ascertained by one or more auditor or auditors." Now, it appears that half-yearly statements were submitted to the directors, and I gather that Mr. Kevans discharged his duties half-yearly, but I shall deal with the case entirely on the assumption that he did it only once a year, because his half-yearly examination probably would not be as complete as the one completed at the end of the year. The 157th rule of the articles provides—"That the auditor shall be supplied with copies of the statements of accounts *seven* days before the intended meeting, and it shall be his duty to examine the same with the accounts and vouchers relating thereto, and to report to the company in general meeting thereon." These are the two rules that define his duty. Rule 158 is, however, important, as showing the materials that were to be placed at his disposal. "The auditor shall have a list delivered to him by the directors of all the books kept by the company, and shall have reasonable access to the books and accounts of the company, and may in relation thereto examine the directors, or other officers of the company." Now, there are two specific things that Mr. Kevans was charged with. In the first place, it was practically left to him to say what books the company ought to keep, and therefore he, in the position of a skilled accountant, was really made an adviser as to what the set of books were that he was to examine, and I take it for granted that the books recommended were sufficient. Another matter was, that in the course of the business they had to some extent ascertained by actual experience what was necessary for their protection. They (the

directors) made an arrangement with the auditor that there should be a monthly checking, and therefore he was bound, dealing with the set of books that he himself provided, to check these books once a month and to audit them once a year. Now, I am not going to minimise the distinction between checking and auditing. I do not agree at all with a great deal of what has been presented to us that Mr. Kevans was to have done in the monthly checking, but the monthly checking was a "checking at the time," a preparation for the future, and a security that the books were carried forward from month to month in the state in which they should be audited. His remuneration was not very large, but it must not be taken to have been inadequate. He also must be taken to have had a knowledge of the business. It was not a business to which any of the directors could have been expected to devote anything like their whole time; and it was a business where, to Mr. Kevans' own knowledge, the clerical staff was cut down to a very low point. Therefore, he must have known that there was more reliance placed upon him, upon his checking, and upon the audit, than might be expected in the case of an ordinary company. That being the measure of his duty—it is the same rule that applies to all, with the exception I have mentioned—what is the nature of the breach of that duty? It is curious that in one English case the breach of duty for which the auditor was said to be held liable was exactly as here—a breach of duty in not detecting the case of misfeasance on the part of others, which was not for the purpose of putting money into their own pockets, but for the purpose of giving a fictitious appearance of prosperity to a company that really was not prosperous. I shall have to say more about that when I come to the question of damages. I think the fairest way to deal with Mr. Kevans in this case is to treat him as being charged with having failed to find just cause of suspicion on the face of these books, which, if found, would have imposed on him the duty of pursuing his suspicion until he found whether it was or was not well founded; and in that I am only following the example of Lord Justice Keane, who, in his judgment, took as an example one particular instance of one particular year, and applied all the rest of the case to that. I am fortunate in the present case to have an instance which was discussed as a fair example of the mode in which the fraud in question was carried out; as an example of the grounds of suspicion—that there were grounds of suspicion—appearing on the face of the books themselves; and also of the means that these books would have supplied (had the suspicion been entertained), in order to detect the frauds. Now, I must entirely disclaim from myself the intention of going to do anything more than what any ordinary intelligent juror would be bound to do if he was trying Mr. Kevans on his indictment for having failed to discover what appears on the face of the books themselves. This is not a question of technical knowledge, nor a question in which

it could be capable of misleading anyone. The English cases have established that the auditor is entitled, in the absence of the elements of suspicion, to assume that the books are honestly kept, and that, therefore, unless on the face of a presumably honest book something appears to excite his suspicion, he is not guilty of negligence, whatever other people might be in their departments, if he does not discover that something was wrong. Now, the one example is the case of Hill & Sons, for the period where the balance was struck as of the 31st of December 1892 and the 31st of December 1893. In that year there was an increase, as now appears, in the suppressed invoices and in the carried over invoices, and this account is one of those in which that increase took place, and it has been taken and discussed as an instance and as an example of others in the book (Creditors' Ledger), presumably dealt with in the same way. At page 108 of the Ledger the account of Hill & Sons—if I use a technical word wrongly I hope I may be forgiven—is ruled on the 31st of December 1892. The figures immediately below the ruling indicate to my mind that, when it was ruled, all the items for that year were then written up. From the 12th of August to the 20th of December 1892 there were, altogether, items that amount only to £57 3s. 9d., and all of these items are on the one date, December 20th. There were no transactions with Hill & Sons between the 12th of August and the 31st of December, except whatever is covered by the entries of the 20th of December. Therefore, if there was anything written in it could only be the £57 3s. 9d.; but I think it is admitted that these were not written afterwards, because after that, and the very last item above the ruling, is the correction of an error of £500, which is taken from the contra side of the account; and there is a ruling on the top of £736 4s. 9d., and there the account ends for the year 1892. On the face of the book there is no subsequent entry in Hill & Sons' account at all going back into 1892. It is a perfectly legible account for 1892, closed on the 31st of December, balanced by the correction of an error, and, as I call it, closed in every sense. I will assume that all the transactions of 1892 were included in the accounts of 1892, and that there was nothing carried forward. Now, there is also a ruling on the 31st of December 1893—there is on the face of the book, as it stands, an undoubted ruling as of the 31st of December 1893. But what is the case? It is conceded that in striking a Trial Balance for the purpose of statements of account for the year 1893, three items that only appear on the right side of page 150 were in the book at the time. In the book now, before we come to the ruling, there were inserted below these and after them a half column of items totting to no less than £698 19s. 11d., and the whole of that is included in the amount of these "kept-back invoices" for the year 1893. Well, I will admit that it is not the business of an auditor when he comes to strike his Trial Balance on the 31st of December for the purpose of a meeting, to

have every account closed and balanced, but he must strike a Trial Balance, and he did so; but at a figure, 15th of December. I do not agree with the monthly check that was taken. Some of these items now introduced must have been there, and therefore within a month of the 31st of December 1893, if the monthly check had been carried out, the representative of Mr. Kevans would have found that after the figure which he had taken for ascertaining the financial position of this company, a string of figures had been put in, all in December, and all within a day or two of the 15th, the day at which the financial position of the company had been ascertained. I think that was something; but it is nothing to what follows, because between that time and whatever time this book was ruled there then follows a further string of items—nearly £600 in amount—that go up to the 3rd of November and go down as far as the 14th of December. I cannot conceive any more clear or glaring grounds of suspicion than to discover in the account of a single customer items amounting to such a sum having got into the books after the Trial Balance is struck, under dates going back two months prior to the period of the ascertaining of the Trial Balance. There appears to be a further thing—a monthly check was to be adopted, and that would have put an auditor on inquiry. It appears to me that the moment I come to the conclusion that that was on the face of it a suspicious mode of dealing with Hill & Sons' figures, I am bound to show how it would be corrected. I can add nothing to the judgment of Lord Justice Holmes—viz., that it would then have been necessary to call for the creditors' statements of account, and at that moment they would have disclosed on the face of them not merely those post-dated items, but the suppressed invoices also; and at the instant that this discovery was made there is an absolute conviction of something wrong forced upon the mind of the auditor. It, therefore, occurs to me that, upon these two branches, all that is required, both to show the negligence, to arouse suspicion, and to supply the means of putting a stop to the frauds, is to be found on the face of the book, and for all I have said I have no foundation except what is upon the face of that book (Creditors' Ledger). I now take the three English cases, in order to make a few observations on each. In 36 Ch.D., in the *Leeds Estate Building Investment Co.*, Mr. Justice Stirling held that the manager and auditor were liable. It is right to say that the procedure in the other cases was different from this Leeds case; and it is important to bear in mind that the other two were under the 10th section of the Winding-up Act. In this case the auditor was held liable, and Mr. Justice Stirling held him liable, saying that it was his duty to see that no part of the capital was applied to any other than the proper purpose, and, in particular, that no part of the capital was returned to the creditors—that is, in dividends—except in the cases in which a reduction of capital was permitted by various Acts of

Parliament. The next case, and the most important one, is the *London and General Bank* (2 Ch.D. 1895, 681). That was a procedure under this 10th section. Mr. Justice Lindley says, "an auditor has nothing to do with the prudence or imprudence of the way in which the business has been carried on; nothing to say as to whether it was properly im- properly, profitably or unprofitably carried on, provided he discharges his own duties to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that." But then comes the question, "How is he to ascertain that?" The answer is by examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking the common trouble to see that the books show the company's true position. He must take reasonable care to see that this is done (page 682), otherwise the audit reduces itself to an "idle farce." I have endeavoured to keep myself within that, and think that that principle is the very lowest upon which we can define the duties of an auditor. In the *Kingston Cotton Mills* case (1 Ch.D. 96, 279), Mr. Justice Vaughan Williams held, "that it was the duty of the auditor to have made a calculation outside the books which, if made, would have shown that the amount of the stock was overstated on the books." In this case of the stock-taking and the over-valuing, &c., Mr. Kevans is exonerated. Now, time after time, this passage about the "watch dog and the bloodhound" has been made use of, and I would wish to say a word regarding it, too. His Lordship then read from Lord Justice Lindley's judgment the passages dealing with the duties of auditors, in one of which it was laid down that "an auditor was a watch dog, but not a bloodhound." This, Lord Justice Fitzgibbon remarked, was very unfair to the bloodhound, who was just as little likely to have his sense of suspicion aroused as the watch dog. Applying this instance of the dogs to the present case, was not the watch dog bound to bark? and if, when sniffing round, you hit upon a trail of something wrong, surely you must follow it up, and there is just as much obligation on the auditor, who is bound to keep his eyes open and his nose, too. As in the case of the hound, the auditor will follow up this trail to the end, and the first things he will "root up" are those statements of account, and then the fraud is discovered. On the question of damages, the damage here—and I guard myself against expressing any individual opinion upon anything more than is necessary—is sufficiently supplied for the purpose of showing the existence of pecuniary losses. In the first place, there has been a paying away of a large amount of money in dividends to the shareholders that had not been earned, and therefore at the time that that was stopped the company ought to have been in possession of a money capital, which they had parted with by paying it away to their shareholders. It would be premature to discuss the pecuniary damage until

the financial position of the company is finally ascertained. Then, again, had this system of the suppression—the carrying forward—of invoices been detected sooner, it would have been open to the directors to have done something to stop it. They had several ways, either to increase their percentages or diminish their dealings—in the latter case thereby producing a less loss; or, they could have stopped the business and wound it up. On the question of the amount of the damages, that depends on the amount of the losses the plaintiff has suffered, taking all the circumstances of the case into consideration. We have not all these circumstances before us and it is, I say, premature to discuss damages at all beyond the point I have discussed them. I have come with much reluctance to the conclusion that a professional man has failed in his duty, and I am glad to be able to think that the worse that could be said of the case is this:—That, in what is so small a company, Mr. Kevans and his representative, who went there to do this audit (for which Mr. Kevans received a very small fee), were deceived not by any glaring or probable fraud such as they would be on the watch against, but by a thing that was done more for the purpose of giving an appearance of fictitious prosperity to a company which did not exist than that of putting money into the pockets of shareholders. That, however, cannot alter the legal liability if it is based, as I am satisfied it is, upon the failure to have suspicion aroused.

The Lord Chancellor also concurred, and the appeal was accordingly dismissed.

The case of MAYNARDS, LIM. *v.* MAYNARDS AND OTHERS.

(Decided before Mr. Justice FARWELL, in the Chancery Division, on the 16th January 1900.)

Company Prospectus—Alleged False Statements—Accountants' "Certificate" of Profits—Certificate merely an Estimate—Action against Promoters and Accountants for return of Money and Shares (or for Damages)—Promoters and Secret Profits.

In this case the plaintiff company, which was incorporated on March 19th 1896, for the purpose of carrying on a wholesale and retail confectionery business, alleges that certain of the defendants, who were promoters of the company, are liable to return money and shares to the company, on the ground that they made secret profits out of its formation, and that certain others of the defendants are also liable to return money and shares (or in damages) for having knowingly made false statements as to the profits, &c., of the businesses taken over by the company; which statements were embodied in the prospectus.

Sir E. Clarke, Q.C., Mr. Bramwell Davies, Q.C., and Mr. A. R. Kirby appeared for the plaintiffs; Mr. Swinfen Eady, Q.C., Mr. Hughes, Q.C., and Mr. Stewart Smith for Messrs. Oscar Berry & Carr; Mr. Younger, Q.C., and Mr. Buckmaster for Messrs. Edwards, Etherington, and Willmott; Mr. R. Isaacs, Q.C., and Mr. Gregson for Mr. Thomas Maynard; Mr. Ashton Cross and Mr. Duka for Messrs. Edridge & Jackson; Mr. E. Ford for Mr. George Plumbley; Mr. H. E. Wright for Mr. Hatcher; and Mr. Parikh for Mr. F. C. Rhys.

Sir E. Clarke, in opening the case for the plaintiffs, said that before the incorporation of the company the defendant, Mr. T. Maynard, was carrying on business as a confectioner in sixteen shops in London. He put himself in communication with the defendant Mr. F. C. Rhys, and through him with the defendants Messrs. Edwards, Etherington, and Willmott and Mr. George Plumbley, with the view of promoting a company; and all these defendants subsequently acted as promoters of the plaintiff company. Mr. Rhys concealed his identity under a company called the Home, Foreign, and Colonial Contract Company, which had only seven subscribers. The promoters decided to acquire a number of other businesses besides those of Mr. Thomas Maynard, and entered into contracts giving the option to purchase thirty-five other businesses carried on in different parts of England. At a later period Mr. Charles Riley Maynard, who was originally a defendant in the action, but with whom a settlement had been effected, agreed to sell his six businesses in London to the intended company. On March 4th 1896, the defendants Messrs. Edridge, Hatcher & Jackson, who were trade valuers, made a report addressed to the directors of Maynards, Lim., although the company was not then in existence, in which they valued the businesses to be acquired by the company as a going concern (including goodwill but exclusive of stock) at £72,500, and reported that they were satisfied that the net profits were then £15,000 per annum. This report appeared in the subsequent prospectus. On the same day the defendants Messrs. Oscar Berry & Carr, Chartered Accountants, furnished the following report to the promoters, but addressed to Maynards, Lim.:—"We have examined the accounts of the forty-six retail businesses proposed to be acquired by your company, the majority of which have been established for several years. The accounts show that the businesses have been steadily increasing, the sales now being at the rate of £39,542 7s. 5d. per annum. We have also examined the accounts of the wholesale businesses carried on in connection with these retail shops, and find that the sales are at the rate of £17,795 11s. 7d. per annum, of which by far the greater portion is for goods supplied to customers other than the retail businesses, the total sales of the combined retail and wholesale businesses above referred to being at the rate of £57,337 19s. per

annum. Owing to the absence of figures showing the expenses of some of the businesses we are unable to ascertain the exact net profit of the whole of them, but from our knowledge of the extremely profitable nature of the confectionery trade and from the facts disclosed during our investigation we are satisfied that the profits of the businesses are large, and that after payment of the interest on the preference shares there will remain a profit sufficient to pay a substantial dividend upon the ordinary shares." This report also appeared in the prospectus. As to these two reports, the plaintiffs would contend that Messrs. Edridge, Hatcher & Jackson never surveyed the premises in such a way as to enable them to form any opinion as to their value, and never, as the promoters knew, properly investigated the trading and were not satisfied that the net profits were £15,000 per annum; and that Messrs. Oscar Berry & Carr never had any materials before them, for they did not exist, for forming an estimate of the net profits. On March 9th 1896 an agreement was signed between Mr. Thomas Maynard and a Mr. Goodman, who was a nominee of the promoters, for the sale by Mr. Thomas Maynard to the company of his own business and thirty-five other businesses for £75,000, exclusive of the stock. Mr. Maynard appeared as the vendor of all the businesses in order that they might all have the benefit of his name and might appear to have been carried on by him. The capital of the company was £140,000, divided into 60,000 preference and 80,000 ordinary shares. On March 13 1896, the promoters issued a prospectus offering 52,500 preference and 60,000 ordinary shares to the public, and stating that the purchase price was £115,000, which included £40,000 for Mr. C. R. Maynard's business, but no reference was made to the fact that any part of the purchase price was to be paid to any of the promoters other than the ostensible vendors. The public subscribed largely for the shares. As a matter of fact £29,000 in cash and shares was paid to Mr. C. R. Maynard, £12,000 in cash and shares to Mr. T. Maynard, £33,200 in cash and shares to other vendors, and £44,484 18s. 3d. to or among the promoters and their nominees. The promoters also paid Messrs. Edridge, Hatcher & Jackson £350 in cash and £750 in shares. The price of Mr. C. R. Maynard's business was increased to and fixed at £40,000 in order that £11,000 might be secretly divided among the promoters. The profits of the company for the first year amounted to £2,714. A committee of shareholders was appointed, and after an accountant had investigated the various businesses which had been acquired, the present proceedings were instituted.

Mr. W. B. Keen, examined by Sir E. Clarke, said that he was a Chartered Accountant, and in September 1897 he was employed to examine the books of the various businesses taken over by the

plaintiff company. There were fifty-one businesses in all, and the books varied greatly in character, and in no case was he shown a complete set. With regard to the profits of the businesses of C. R. Maynard, the certificate in the prospectus was correct. Sixteen of the businesses taken over belonged to Thomas Maynard, and with regard to these the books covered only a period of nine months, during which time there had been no stocktaking. The net profit for that period was £165 odd, and in his report he put the outside net profits at £365 per annum, without charging managerial services. For the first year of the company's existence the net profit from these sixteen businesses was £60 odd. The purchase-price was £15,000. The other businesses taken over belonged to different persons. In some cases no books were produced, in no case were they complete. In his report he put the total profits at £5,620, without allowing for managerial expenses, head office expenses, or depreciation. It was not correct to say, as was done in the prospectus, that the businesses were steadily increasing. In those cases where three years' books were produced to him the totals for the third year were less than for the first year. The method adopted by Messrs. Oscar Berry & Carr in estimating the net profits was, in his opinion, incorrect. The expenses of the different businesses varied greatly, and no fixed percentage could be realised.

Cross-examined by Mr. Hughes: I am aware that Messrs. Oscar Berry & Carr declined to certify as to net profits.

Witness was also cross-examined by Mr. Ashton Cross, Mr. Younger, and Mr. Parikh.

To Mr. Justice Farwell: Mr. J. J. Clark, of Brighton, was the only vendor who kept proper books, but in no case were books produced to me from which an accountant could arrive at a correct conclusion as to net profits.

Mr. Francis William Pixley, examined by Sir E. Clarke, said he was a member of the Council of the Institute of Chartered Accountants. There had been submitted to him certain documents which, he understood, had been supplied by Messrs. Oscar Berry & Carr to the last witness (Mr. Keen) for the purpose of showing how their figures had been arrived at when they reported that the accounts of the businesses showed increasing profits, sufficient to pay a substantial dividend on the ordinary capital after paying the dividend on the preference shares. It was not the fact that those accounts showed that the businesses had been steadily increasing. There was only one document dealing with Maynard's businesses at Brighton, and it covered only one single year, so it could not show whether the businesses had been progressive; but the books appeared in this case to have been correctly kept. In other cases the

figures were only for one year; so that they did not show whether there had been an increase or decrease. Figures for 1893, 1894, and 1895 were given in other cases. In Stewart's case the takings in the first year were £4,676 17s. 3d., in the second year £4,122 6s., and in the third year £3,830 11s. 10d., showing a decrease in each year. In Vose's case the figures were £5,613 9s., £6,280 os. 6d., and £6,280 4s. 7d. respectively, being an increase each year. In Jarvis's case the figures were £2,423, £2,490, and £2,325 respectively. Having regard to the whole of the figures shown to him, there was no justification for saying that these were progressive businesses. There was nothing in the documents produced to him to justify the statement by the trade valuers, Messrs. Edridge, Hatcher & Jackson, that they were "satisfied that the net profits were upwards of £15,000 per annum."

Cross-examined by Mr. Swinfen Eady: A person knowing the trade could form an idea, from the turnover, of what profit ought to be made. If a large number of shops were amalgamated, and conducted under a central management, the profits would be greater than if the businesses were carried on separately. The fee of 700 guineas to Oscar Berry & Carr was, he would say, a full fee, but not excessive for the work.

Mr. Frederick Whinney, examined by Sir E. Clarke, said he was an accountant in the City, and had practised for forty years. He had seen the certificates of the valuers and the accountants in the prospectus, and had had the papers submitted to him which had been shown to the previous witness. They suggested a profit of between £14,000 to £15,000 a year; but he did not think they could be depended upon, because they were not based on accounts. They were estimates. He did not believe in estimates at all, and if one was giving a certificate, if he could not get real information, he ought to state that he had been obliged to estimate so-and-so.—Was there anything in the documents which would entitle a person to say he was satisfied that the net profits amounted to £15,000?—Witness: I would not have said so, and I do not think anyone else ought to have said so.

By Mr. Hughes: He did not know that Oscar Berry & Carr declined to certify the net profits.—Mr. Hughes: They said they were unable to ascertain the exact net profit, but that from their knowledge they anticipated, besides the 6 per cent. on the preference shares, a substantial dividend for the ordinary shares. There is no mention of £15,000, or any sum, by Oscar Berry & Carr?—Witness: But you find it inferentially.

Mr. Herbert Furber, examined by Mr. Kirby, said he had examined most of the shops scheduled in the prospectus. Some of these were held on yearly tenancy, others on leases averaging twelve and a half

years. He did not value the goodwill of those held for a year or less, and his valuation of the goodwill of the others was £4,065.

Mr. William Izard, auctioneer and trade valuer, in answer to Mr. Kirby, said that he had special experience in the valuation of confectionery businesses. Apart from factories, he had inspected over forty of the shops of this company in London, Brighton, and elsewhere, and he valued the leaseholds at £3,750 and £700 for a shop in Newcastle. In his opinion, there was nothing to be added to those figures for goodwill.—By Mr. Ashton Cross: He had put no value at all on any of the company's shops that had been shut up. It was his experience that confectioners commonly bought and sold without proper books, and businesses were bought and sold often only upon estimates.

Mr. John Jackson Clark, examined by Sir E. Clarke, said he carried on confectionery businesses at Brighton under the name of Maynard, and he had lately joined the board of directors of the plaintiff company. Mr. Rhys communicated with him as to the purchase of his businesses. He gave Mr. Rhys no accounts regarding the factory, as he told him it was no good, and he gave Oscar Berry & Carr the same information. He had said all along that he was only selling the goodwill of the retail businesses; there was no goodwill of the others. Rhys only had witness's statement, but a clerk of Oscar Berry & Carr came and examined the books for the year 1894. The books went back to 1888, but he did not know whether the clerk examined beyond the year 1894.

Mr. C. R. Maynard, examined by Sir E. Clarke, said that he was managing director of the plaintiff company. Early in 1896 he came into communication with Mr. F. C. Rhys, and on March 14 of that year signed an agreement with Mr. Goodman on behalf of the company to sell his business to the company. The consideration was £40,000, £25,000 to be in cash and £15,000 in shares. He received £14,000 in cash out of the £25,000, and was allotted 15,000 shares, half preference and half ordinary. Messrs. Edwards, Etherington, and Willmott, and Mr. G. Plumbley received £10,000 of the nominal consideration money in accordance with an understanding he had entered into with them. He obtained an indemnity in exchange for them; £1,000 of the consideration money went to Mr. Rhys, but he did not know under what circumstances. In April 1897 he valued plant, machinery, and fixtures acquired by the company. He thought the valuation was between £16,000 and £17,000. That included businesses acquired after the promotion of the company.

Cross-examined by Mr. Swinfen Eady: The directors issued a circular criticising Mr. Keen's report, and he believed those criticisms

to be well founded. He visited all the shops before completion of the purchases and reported on them, and he understood that two of the directors had also done so.

Cross-examined by Mr. Parikh: Mr. Rhys might have settled the costs of witness's solicitors and the accountants' costs out of the £1,000 that went to him.

Mr. E. R. Polden, chairman of the plaintiff company, said, in answer to Sir E. Clarke, that he was a director of a printing business, and had done a good deal of printing in connection with companies promoted by Messrs. Edwards, Etherington, and Willmott. Mr. Edwards first introduced this business to him, and he agreed to underwrite 2,000 shares. Mr. Edwards afterwards suggested that he should become a director, and he agreed to this. About March 1896 Mr. Edwards gave him £100, but he considered that it was given as a present for the personal trouble he had taken in looking after the printing for Mr. Edwards's firm. It was about the same time that he applied for 100 shares in the company to qualify him as a director. He never saw Mr. Rhys nor heard of Mr. Plumbley till afterwards. He did not know that Messrs. Edwards, Etherington, and Willmott, and Mr. Plumbley were to receive £21,000 out of the sum paid to Mr. T. Maynard. He did remember a conversation with Mr. Edwards, in which £30,000 was mentioned as the profits and costs of the promotion of the company. Had he not believed the statements in the prospectus he would not have become a director.

Cross-examined by Mr. Isaacs: He knew before completion that Mr. T. Maynard was not the real vendor of all the businesses.

Cross-examined by Mr. Swinfen Eady: The directors did not act in accordance with the directions of the promoters.

Re-examined by Sir E. Clarke: He paid £100 to the committee of investigation, but without any admissions, in order that action against him might be stayed.

Mr. Bramwell Davis summed up the evidence for the plaintiffs, and said that the plaintiffs claimed that the defendants were liable to return to the company the difference between the actual value of the businesses sold to the company, which was between £16,000 and £17,000, and the price paid for them, £75,000.

Mr. Rufus Isaacs, on behalf of Mr. T. Maynard, contended that the directors knew from the beginning that Mr. T. Maynard was not the real owner of all the businesses acquired by the company. His client had done nothing which was not disclosed to the directors and, through them, to the company. There was no evidence of complicity against him with regard to the prospectus, and as he had nothing to do with

the promotion he did not stand in any fiduciary position towards the company. All that was suggested against Mr. Maynard was that, owning only sixteen shops, he purported to be the vendor of the rest.

Mr. Swinfen-Eady said that the charge against his clients, Messrs. Oscar Berry & Carr, who held a high position in their profession, was either fraud or nothing. There was no question of contract with the directors, because their report was furnished before the company was formed. The allegations made against his clients were wholly false, and the fullest evidence would be given to prove that. For the purposes of the report Messrs. Oscar Berry & Carr examined fifty-one businesses in all, and their fee was to be 700 guineas. It was subsequently arranged that part of the fee should be paid in shares of the company. Mr. Bramwell Davis had said that the plaintiffs' claim against the defendants was for £60,000, the difference between the value of the businesses, as assessed by the plaintiffs, and the price paid. But while the action was pending the plaintiffs' solicitors had written a letter to his clients' solicitors saying that their claim was not for fraudulent misrepresentation of the value of the businesses acquired by the company, and on that ground they refused discovery of certain documents. Therefore, so far as his clients were concerned, the plaintiffs' claim for £60,000 must fall to the ground.

Mr. Justice Farwell: In the face of that letter, Mr. Bramwell Davis, I do not quite see how I can give you leave to amend your claim. However, perhaps it will be better to hear the evidence.

Mr. Swinfen Eady: The evidence would prove that Messrs. Oscar Berry & Carr had acted solely as accountants in the matter, and had no motives for acting otherwise. They were asked to investigate certain businesses and certify as to profits. As the materials were not sufficient they declined to certify as to profits. They were then instructed to ascertain the amount of the takings, which could be done with fair accuracy. Given the takings, a person of experience could then compute what the profits were likely to be—substantial or otherwise. It was true that when the company took over the businesses the net profits fell off, though the takings increased. He hoped, however, that his evidence would show where the leakage took place.

Mr. W. R. T. Carr said, in answer to Mr. Swinfen Eady, that he was partner in Messrs. Oscar Berry & Carr and had had a long experience as an accountant. The investigations into the businesses acquired by the plaintiff company were conducted under his personal supervision. He was told the fee was to be 700 guineas. Before the certificate was given he had never heard that part of the fee was to be paid in shares, or that payment was conditional on the company being successfully floated. They examined fifty-one businesses in all—forty-six retail and

five wholesale. They went through the accounts of ninety-five years. They were instructed at first to certify as to net profits, but the net profits could be ascertained from the books of only twenty of the businesses. This was told to Mr. Rhys, and they were then instructed to ascertain the sales, which they did. Mr. Gold, one of the original directors, was also informed that they could not certify as to net profits. In a great many of the businesses their investigations covered a period of three years.

Witness then went at great length into the details of the accounts taken by his firm with a view to proving the accuracy of their report.

In answer to Mr. Swinfen Eady, witness said that he still retained the shares in the plaintiff company which were given in part payment of the fee of 700 guineas, though he had been twice approached to sell them. The shares went to a premium. Under the company the turnover of the businesses largely increased, but the net profits fell off.

Cross-examined by Sir E. Clarke: He should not like to say that the accounts he examined would support the statement in the prospectus that the profits were sufficient to pay 15 per cent. on the ordinary shares. He did not consider his report as a certificate of net profits. When he saw the prospectus he did not remonstrate with the directors as to any statements in it. It was by Mr. Rhys's instructions that he addressed the certificate to the directors. Out of the forty-six retail businesses thirty-five had accounts sufficient to enable him to give the profits approximately.

Witness was then cross-examined at great length on the accounts of the various businesses acquired by the company, with a view to proving the allegations of the plaintiffs that the businesses were not increasing at the date of the certificate, and that there were no materials sufficient to allow profits to be estimated.

Mr. Edridge, examined by Mr. Ashton Cross, said that he was a member of the firm of Edridge & Jackson, which at the date of their certificate was Edridge, Hatcher & Jackson, and had had a long experience as a trade valuer in the confectionery and allied trades. Together with his partner, Mr. Jackson, he inspected the various leasehold premises in London, Bristol, Bath, and Brighton acquired by the company, and valued the fixtures and fittings. Mr. Jackson inspected the businesses in the North of England. The values were entered in books on the spot, and all the valuations were honestly made. Confectioners seldom kept complete sets of books, and in such cases it was usual for valuers to inspect the shop, ascertain rates and taxes and other details, such as number of assistants, class of trade, competition, and character of management. A valuer of experience could then form a pretty good

estimate of the amount of trading, and by that process the net profits could be approximately arrived at. They had gone through that process in the present case, and honestly satisfied themselves as to the amount of the net profits.

Cross-examined by Sir E. Clarke: They depended on Messrs. Oscar Berry & Carr for the correctness of the takings. He still believed that the net profits were £15,000 per annum at the date of his report.

Mr. S. P. Jackson, examined by Mr. Duka, confirmed the evidence of the previous witness.

It was notified that the case against Mr. Thomas Maynard had been settled.

Mr. F. C. Rhys, examined by Mr. Parikh, said that he held in 1895 contracts for the purchase of certain confectionery businesses, and entered into negotiations with the Home, Foreign, and Colonial Contract Company for the transfer of the contracts to that company. He had no other connection with the Contract Company. Ultimately he employed that company as his agents to dispose of his contracts, which they did. He had taken no part in the formation of the plaintiff company. The directors knew that certain cash and shares were given to him, his name being on the nomination.

After Mr. Younger and Mr. Parikh had addressed the Court on behalf of their respective clients,

Sir E. Clarke said that the plaintiffs did not ask for judgment against Mr. Rhys, and that it had been settled that judgment should be entered against Messrs. Edwards, Etherington, and Willmott for moneys received from the company and not accounted for. He wished it to be understood that all charges of fraud against Messrs. Edwards, Etherington, and Willmott were withdrawn.

Mr. Ford, on behalf of Mr. George Plumbley, contended that all his client received was a fair remuneration for the trouble and risk of promoting the company. The directors knew he was receiving money, so that his profits could not be called secret.

JUDGMENT.

Mr. Justice Farwell: I am convinced that Messrs. Oscar Berry & Carr and Messrs. Edridge, Hatcher & Jackson acted quite honestly, and were honestly satisfied of the correctness of their reports. Nor am I satisfied, though that is not the issue I have to try, that their reports were not substantially correct. The plaintiffs have brought charges of fraud against these defendants, and those charges having failed I see no reason to depart from the usual rule as to costs. The action as

against Messrs. Oscar Berry & Carr, Messrs. Edridge & Jackson, and Mr. Hatcher must consequently be dismissed with costs. The case had been disposed of as against all the defendants except Mr. Plumbley. He had already stated that the charges of fraud against Messrs. Oscar Berry & Carr and Messrs. Edridge, Hatcher & Jackson had broken down, and he would now reiterate his belief that those gentlemen had acted in the matter with honesty and integrity. As to Mr. Plumbley, he was admittedly a promoter. It had been argued that as the directors knew of the payment to him that amounted to notice to the company, and the company, consequently, could not sue. In his opinion, however, in a matter of this nature notice to the directors did not bind the company. The directors were not agents of the company to pay money beyond the purchase money. Mr. Plumbley must, therefore, be held liable, and, as Sir E. Clarke had intimated that what the plaintiffs now claimed was £16,000, there must be judgment against Mr. Plumbley for that amount, with liberty for him to set off whatever sums were recovered, in accordance with the various settlements of the case, from the other defendants. That judgment would not, however, carry costs, as the charge of fraud against Mr. Plumbley had broken down.

The case of JOSEPH HARGREAVES, LIM.

(Decided before Mr. Justice COZENS-HARDY, in the Chancery Division,
on 15th February 1900.)

*Company Winding-up—Misfeasance Summons—The Liability of Auditors
and Directors.*

In this case a summons was taken out by the voluntary liquidator of Joseph Hargreaves, Lim., asking the Court to hold three directors and the auditor of the company liable for misfeasance in having declared dividends, amounting to £2,602, out of capital. The directors who were respondents to the summons were Messrs. Pullen, Holloway, and Brown; and the auditor was Mr. Theodore Brook Jones, Chartered Accountant, of Albion Street, Leeds. The company carried on business as spinners at Shipley and Bradford, and the allegation against the respondents was that in 1894 and the two following years dividends were declared when the company had really made no profit. The company had passed resolutions for voluntary winding up in August 1897.

Mr. Hughes, Q.C., and Mr. Percy Wheeler appeared for Mr. Gray, of Bradford, the liquidator; Mr. Eve, Q.C., and Mr. R. J. Parker represented Mr. Jones; and Mr. Astbury, Q.C., and Mr. Stewart Smith were counsel for Mr. Pullen. The other directors were not represented.

The affidavit of Mr. Jones was read by Mr. Eve. The deponent stated that he had never received any remuneration from the company, and he had not acted as auditor after the 22nd of June 1895. A valuation of the machinery had been made by Mr. Marshall in 1894, and that gentleman had arrived at a figure of £16,119, with an addition of 10 per cent. owing to the marked improvement in the textile trade.

Mr. Jones was cross-examined by Mr. Hughes. He said he saw to the preparation of the memorandum and articles of association, and he gave all the information he could to the shareholders at their first meeting. He knew that certain sums were paid to the shareholders as dividend, but when he found no profit had been made he refused to sign the Balance Sheet. He several times spoke to Mr. Holloway on the subject, but nothing was done. He denied that he concurred in any resolution that any sum should be carried forward. Witness was not re-appointed auditor in December 1895, but his firm acted as auditors more through friendly feeling towards the directors than anything else. He never received a penny as remuneration, and had never sent in an account, though one of his clerks, contrary to instructions, had sent in an account to the liquidator. He acted as much in the shareholders' interest as in the directors', but he did not report to the company in general meeting. He more than once protested to Mr. Holloway that dividends were paid before the accounts were audited. He could swear positively that there were no Balance Sheets signed by him or on his behalf. Dividends had been paid to him in respect of the shares he held in the company.

Re-examined: I told the directors that they were liable for the dividends which had been paid out of capital.

Mr. Stewart Smith read the affidavit of Mr. Pullen, to the effect that that gentleman up to the formation of the company had been general manager of Mr. George Hargreaves' mills, Holloway was cashier, and Brown salesman. After the company was formed they continued to work in their own departments. He never had brought to his notice the objections to the accounts which the auditor made to Mr. Holloway. He did not, however, dispute his liability in respect of such dividends as had been paid out of capital. The learned counsel desired to say that Mr. Pullen was the holder of only 250 ordinary shares in the company, on which there had never been any dividend paid, and he had never received a shilling out of the company in which he had sunk all his money.

His Lordship asked if the liquidator would be content with an order for the payment of the 1896 dividend only.

Mr. Hughes desired to be moderate, and said he would take an order that the directors were jointly and severally liable in respect of

£1,177. As regarded the auditor, he argued that it was a plain case of neglect of duty against him, as he should either have brought the matter to the knowledge of the shareholders or he should have resigned.

JUDGMENT.

Cozens-Hardy, J., in giving judgment, made an order against the three directors for the 1896 dividend, with interest and costs. As regarded the question between the liquidator and the auditor, his Lordship said it was sought to make the auditor liable under circumstances the like of which, so far as he was aware, had never occurred before. Mr. Jones had never signed any Balance Sheet, no resolution of the company or of the directors had ever been passed for the payment of a dividend, and nothing had been done by the directors or anybody on the footing of any inaccurate, dishonest, or insufficient statement of Mr. Jones. He told the directors that in his opinion the payment of a dividend which had been made before his first audit was improper, because it was only justified by reason of the appreciation of the value of the machinery, which appreciation, assuming that it was proper, ought not to have been carried to Profit and Loss, but to a Suspense Account. For that reason Mr. Jones deliberately refused to sign the Balance Sheet, and he would not certify its correctness. The payments were actually made before the audit of the accounts was completed. Lord Justice Lindley had said the duties of an auditor were that he must be honest, must not certify what he did not believe to be true, and must take reasonable care and skill before he certified accounts as true. Mr. Jones had fully come up to that definition, and he (the learned Judge) was not prepared to extend the liabilities and responsibilities of auditors to the enormous extent that he should be obliged to do if he were to accede to the application. The summons must be dismissed with costs as against Mr. Jones.

The case of THE ASTRACHAN STEAMSHIP COMPANY, LIM., AND OTHERS *v.* HARMOOD, BANNER & SON.

(Decided before Vice-Chancellor HALL, in the Chancery Court in the County Palatine of Lancashire, on the 2nd March 1900.)

Action against Auditors—Alleged Negligence—Manager of Single-ship Companies—Failure to detect Defalcations.

This was a case of great commercial interest, likely to form the test case of a series of five cases. The plaintiffs were the shareholders of the Astrachan Steam Shipping Company and of the Rover Shipping Company; the defendants being James Sutherland Harmood-Banner,

Henry Douglas Eshelby, George Nicholson, and William Alexander. For the plaintiffs, Mr. Joseph Walton, Q.C., with whom was Mr. Horridge, appeared, and for the defendants Mr. Ralph Neville, Q.C., and Mr. R. D. Rotch. In opening the case for the plaintiffs, Mr. Walton, having explained that the Rover Shipping Company had been added to the plaintiffs and Mr. Alexander to the defendants merely in order to meet possible technical objections, said the defendants were gentlemen of very high standing in their profession as accountants in Liverpool, and this action against them was for damages for alleged negligence in the discharge of their duties as the auditors of the Astrachan Steamship Company.

The Vice-Chancellor: Why has not the case been taken to the Nisi Prius Court at the Assizes?

Mr. Walton: Well, I don't know, except that this Court was thought to be a tribunal before which it was very desirable to have the action tried.

The Vice-Chancellor: Have the defendants any objection to the hearing in this Court?

Mr. Rotch: We have answered the interrogatories and have no objection.

Mr. Walton (proceeding) explained that the Astrachan Company was one of a series of five single-ship companies standing on the Court list as plaintiffs, each company managed without directors by one William Western Tapscott, a man of no great means, but who had been well known in Liverpool for his success in obtaining capital from people who were willing to subscribe for the building of the various ships severally owned by this group of single-ship companies. The Astrachan Company was registered in February 1892, and Tapscott, as manager, had a salary of £200 a year plus 2½ per cent. on the gross earnings of the steamer. As there were no directors, the only safeguard of the shareholders was the audit by the firm of the defendants, who audited the accounts of this company and of the other single-ship companies which Tapscott managed. After narrating the bankruptcy, prosecution, and imprisonment of Tapscott, counsel went into details of the finances of the Astrachan Company as they were revealed to defendants at their first audit in 1893, the alleged negligence of the defendants being that they did not report to the shareholders Tapscott's peculiar mode of dealing with cash balances. Briefly, what Tapscott did was to present the accounts of the various companies for audit at different times, and by keeping in hand a sum of money which went all round he contrived to balance each company's Cash Account for a short period in turn. The sum of money went round while it lasted, but it was first under

one thimble and then under another. (Laughter.) The question thus was whether defendants ought not to have asked for a full explanation of the extraordinary state of things obviously disclosed by this company's books, either with or without reference to the other companies' accounts. That the strange state of things was obvious was clear from the rough notes of the defendants' clerk, who went through the books before submitting the Balance Sheet of this company to his employers to certify. In all, Tapscott, who used the credit of these companies for his own purposes, had borrowed from the various companies £44,965 at the time he failed. While the first audit of the defendants ought to have revealed the state of affairs to the shareholders, the second audit by the defendants exhibited a kindred state of affairs, but on a larger scale, the sum belonging to the Astrachan Company which Tapscott had on loan for his own use rising to £6,935. Interest on these loans was openly debited to Tapscott in the Ledger of the company, but the interest was never paid. (Laughter.) It was not, as his Honour had remarked, the business of an auditor to act as a detective, but he ought to be a watch-dog. Supposing things were kept out of the books altogether, the auditor would not be held responsible for that. The way, however, in which Tapscott borrowed money from this company, even to the extent of over-drafts at the bank, keeping large sums belonging to the company in hand until the eve of the audit, merely replacing those sums for the audit, and again withdrawing them, was most significant. By allowing the shareholders to remain ignorant of the fact that their manager was continuously borrowing their money in large sums, the defendants caused the shareholders in this single company to lose £9,473 more than they would have done had the defendants put a stop to the practice of Tapscott at the first audit, when he had only borrowed £3,874. The total of these two sums (£12,347) represented the loss of the Astrachan shareholders before they transferred their ship to new managers and out of the hands of W. Tapscott & Co.

The Vice-Chancellor remarked that the defendants' omissions must not be read in the light of what was only after-knowledge of the speculations of Tapscott, and Mr. Walton assented.

The evidence of well-known Chartered Accountants of Liverpool, London, and Manchester was then called—Mr. William C. Spenser, Mr. J. M. Henderson, and Mr. John P. Garnett. They all agreed that the state of things palpable on the face of the books of the Astrachan Company called on the defendants either (1) to demand from Tapscott his special authority for borrowing the moneys of the company; (2) to report the position to the shareholders; (3) to have altered the item in the Balance Sheet "cash in manager's hands" to "cash borrowed by manager at 4 per cent. interest." In cross-examination, the witnesses

admitted that it was usual for a manager of a company to have a "Current Account" with the company, but they added that the figures of the manager's "Current Account" in this case were, as far as their own considerable experience went, quite unprecedented.

The hearing of the case for the plaintiffs was then adjourned until the following day.

March 2.

On the resumption, Mr. Walton said: We shall not, I am glad to say, have to trouble your Honour any further in this case, except to make the order which it may be necessary to make under the circumstances. My learned friend, Mr. Neville, on behalf of the defendants, has this morning made a proposal to meet us very fairly in the matter, and it has, therefore, been arranged that the action shall be stayed, and the sum of money paid which has been agreed upon in settlement of all these cases. In one case, that of the Alberta Company, the compromise can probably only be made with the formal approval of the shareholders themselves in general meeting, and subject to that being done, the whole matter will be disposed of by the payment of a sum of money by the defendants to the plaintiffs in the different actions.

His Honour: Are the companies in liquidation?

Mr. Walton: The companies are in voluntary liquidation.

Mr. Neville: One company has bought the assets of all the companies except one, and it is with regard to that company we shall get a resolution of the shareholders. It is in voluntary liquidation, and as I read the section it will be, at all events, safer to get a resolution of the shareholders sanctioning the arrangement we have made. Upon that resolution being come to, the arrangement will be carried out.

His Honour: Exactly; and the only thing necessary for me to say is that there is no imputation on the honour or capacity of Messrs. Harmood, Banner & Son, and that there is no imputation on their capacity as auditors and accountants. But it is perfectly obvious that Tapscott had been manipulating the assets, and they were, like other people, taken in by him.

Mr. Neville: I am obliged to your Honour for that expression.

His Honour: The defendants have to suffer, but it is their misfortune.

Mr. Walton : I should myself have made that remark, but as I had cast no imputation upon either the honour or the capacity of the defendants I thought it better that no such remark should spring from me. I am happy to have the opportunity to endorse what has fallen from your Honour.

His Honour : Yes ; but having regard to the inaccurate reports that so frequently appear, and knowing the character of Messrs. Harmood, Banner & Son, and the fact that they frequently give evidence in this Court, I thought it right to make these remarks, so that there might be no misunderstanding in the minds of the public.

Mr. Neville again thanked his Honour, and this concluded the matter.

APPENDIX C.

THE following extract from the translation of SIR WALTER of HENLEY's "Tretyce off Housebandry" (a manuscript work of the thirteenth century, recently printed by the Royal Historical Society) is of considerable interest, as showing the remarkable similarity of the duties of the Auditor of the present day with those of the Auditor of six hundred years ago:—

"Buy and sell in season through the inspection of a true man or two who can witness the business, for often it happens that those who render accounts increase the purchases and diminish the sales. Have an inspection of account, or cause it to be made by someone in whom you can trust, once a year, and final account at the end of the year. View of Account is made to know the state of things, as well as the issues, receipts, sales, purchases, and expenses, and for raising money. If there is any (money), let it be raised and taken from the hands of the servants. For it often happens that servants by themselves, or others, make merchandise with their lord's money to their own profit; and if arrears appear in the final account, let them be speedily raised, for often servants are debtors themselves, and make others debtors whom they ought not—and this they do to conceal their disloyalty. Those who have the goods of others in their keeping ought to keep well four things: to love their lord and respect him; as to making profit, they ought to look on the business as their own; as to outlays, they ought to think that the business is another's. But there are few servants who keep these four things altogether, as many take, right and left, where they judge that their disloyalty will not be perceived. Look into your affairs often, and cause them to be reviewed, for those who serve you will thereby avoid the more to do wrong, and will take pains to do better.

"In the first place, he who renders account ought to swear that he will render a lawful account, and faithfully account for what he has received of the goods of his lord, and that he will put nothing in his roll save what he has to his knowledge spent lawfully, and to his lord's profit. And the clerk shall swear that he has lawfully entered in his roll what he understands his master has received of the lord's goods,

and has entered nothing in the roll but what he understands may be to the profit of the lord. And then, if he has rendered account before, see how it compares ; and if he is found in arrears of money, corn, or stock, put the whole in a stated money valuation, and charge it at the commencement of his roll, also charge it with receipts of rents and many other things.

“ At the end of the year, when all the accounts shall have been rendered of the lands, the issues, and all expenses of the manor, take to yourself all the rolls, and by one or two of the most intimate and faithful men you have, make very careful comparison with the rolls of the accounts rendered, and of the rolls of the estimate of corn and stock, and according as they agree you shall see the industry or negligence of your servants and bailiffs.

“ The lord of the manor ought to command and ordain that the accounts be heard every year, not in one place but on all the manors, for so can one quickly know everything, and understand the profit and loss. The lord ought to command the Auditors on the manors to hear the complaints and wrongs of everybody who complains of the steward or others, that full justice be done, and that the Auditors do right at their peril.

“ The Auditors ought to be faithful and prudent, knowing their business, and all the points and articles of the account in rents, outlays and returns of stock. And the accounts ought to be heard at each manor, to know the profit and loss, and then can the Auditors take inquest of the doings which are doubtful, and hear the complaints of each plaintiff and make the fines. The steward ought to be joined with the Auditors, not as head or companion of the account, but as subordinate, for he must answer to the Auditors on the account for his doings, just as another. It is not necessary so to speak to the Auditors about making audits, for they ought to be so prudent, and so faithful, and so knowing in their business, that they have no need of others' teaching about things connected with the accounts.”

APPENDIX D.

DEPRECIATION TABLES.

THE following Tables, which have been expressly compiled for this work, are designed to show the gross amount to be debited to Revenue annually in order to write off the requisite proportion of a lease costing £100, having any number of years unexpired.

It is contemplated that each year a corresponding entry will be made to the debit of Lease Account, and to the credit of Revenue Account, in respect of interest (at the rate stated at the head of the column) upon the balance standing to the debit of the Lease Account at the commencement of the year. For example, if a lease having 30 years unexpired is purchased for £100; then, if it is contemplated to credit Revenue Account at the rate of 5 per cent. per annum upon the reducing balance standing to the debit of the Lease Account, it will be necessary to credit that account, and debit Depreciation Account, with £6 10s. 1d. per annum. On the other hand, if the rate of interest be taken at the rate of 4 per cent., then the depreciation will be £5 15s. 8d.

The Table has been worked out to the nearest penny in each case; but, where the figures given have to be multiplied by any considerable number, it is desirable that a slight addition should be made, to compensate for the absence of fractions in the Table. In any event, it is further desirable that some substantial provision should be made to cover the cost of dilapidations at the end of the term.

No. of years unexpired	4 per cent.			5 per cent.			6 per cent.		
	£	s	d	£	s	d	£	s	d
1	104	0	0	105	0	0	106	0	0
2	53	0	5	53	15	7	54	10	10
3	36	0	9	36	14	5	37	8	1
4	27	5	5	28	4	0	28	17	2
5	22	8	11	23	1	11	23	14	10
6	19	1	6	19	14	0	20	6	9
7	16	13	3	17	5	8	17	18	4
8	14	17	1	15	9	5	16	2	1
9	13	9	0	14	1	4	14	14	1
10	12	6	7	12	18	9	13	11	9
11	11	8	2	12	0	9	12	13	7
12	10	13	0	11	5	8	11	18	7
13	10	0	2	10	12	8	11	5	11
14	9	9	5	10	2	0	10	15	2
15	8	19	10	9	12	8	10	5	11
16	8	11	8	9	4	6	9	17	11
17	8	4	4	8	17	5	9	10	10
18	7	18	0	8	11	1	9	4	8
19	7	12	3	8	5	6	8	19	2
20	7	7	2	8	0	6	8	14	4
21	7	2	7	7	16	0	8	10	0
22	6	18	5	7	11	11	8	6	1
23	6	14	7	7	8	3	8	2	7
24	6	11	2	7	4	11	7	19	5
25	6	8	0	7	1	11	7	16	6
26	6	5	1	6	19	1	7	13	10
27	6	2	5	6	16	7	7	11	5
28	6	0	1	6	14	3	7	9	2
29	5	17	9	6	12	1	7	7	2
30	5	15	8	6	10	1	7	5	4
31	5	13	8	6	8	3	7	3	7
32	5	11	10	6	6	7	7	2	0
33	5	10	2	6	5	0	7	0	8
34	5	8	8	6	3	6	6	19	3
35	5	7	2	6	2	2	6	18	0
36	5	5	9	6	0	10	6	16	9
37	5	4	6	5	19	8	6	15	8
38	5	3	3	5	18	7	6	14	9
39	5	2	2	5	17	6	6	13	10
40	5	1	1	5	16	7	6	12	11
41	5	0	1	5	15	8	6	12	1
42	4	19	2	5	14	9	6	11	4
43	4	18	3	5	13	11	6	10	8
44	4	17	4	5	13	2	6	10	0
45	4	16	6	5	12	6	6	9	5
46	4	15	9	5	11	10	6	8	10
47	4	15	0	5	11	3	6	8	3
48	4	14	4	5	10	8	6	7	9
49	4	13	8	5	10	1	6	7	4
50	4	13	1	5	9	7	6	6	11

No. of years unexpired	4 per cent.			5 per cent.			6 per cent.		
	£	s	d	£	s	d	£	s	d
51	4	12	6	5	9	1	6	6	6
52	4	11	11	5	8	7	6	6	1
53	4	11	4	5	8	2	6	5	9
54	4	10	10	5	7	9	6	5	5
55	4	10	5	5	7	4	6	5	1
56	4	10	0	5	6	11	6	4	9
57	4	9	7	5	6	7	6	4	6
58	4	9	2	5	6	3	6	4	3
59	4	8	9	5	5	11	6	4	0
60	4	8	4	5	5	7	6	3	9
61	4	8	0	5	5	4	6	3	6
62	4	7	8	5	5	1	6	3	4
63	4	7	4	5	4	10	6	3	2
64	4	7	1	5	4	7	6	3	0
65	4	6	10	5	4	4	6	2	10
66	4	6	6	5	4	1	6	2	8
67	4	6	3	5	3	11	6	2	6
68	4	6	0	5	3	9	6	2	4
69	4	5	9	5	3	7	6	2	2
70	4	5	6	5	3	5	6	2	1
71	4	5	3	5	3	3	6	1	11
72	4	5	0	5	3	1	6	1	10
73	4	4	9	5	2	11	6	1	9
74	4	4	7	5	2	10	6	1	8
75	4	4	5	5	2	9	6	1	7
80	4	3	8	5	2	1	6	1	2
85	4	2	11	5	1	7	6	0	10
90	4	2	5	5	1	3	6	0	7
95	4	2	0	5	1	0	6	0	5
100	4	1	7	5	0	9	6	0	4

APPENDIX E.

A LIST OF PUBLICATIONS USEFUL FOR PURPOSES OF REFERENCE.

- "Accountants' Accounts," by W. H. Fox.
- "Accountants' and Bookkeepers' Vade-Mecum," by G. S. Whatley.
- "Accountants' (Chartered) Charges," by F. W. Pixley.
- "Balances, Heavy Trial, made Easy," by J. G. Craggs.
- "Balancing, Errors in."
- "Balancing for Expert Bookkeepers," by G. P. Norton.
- "Bookkeeping, Abstract System of," by J. McLaren.
- "Bookkeeping, &c." by G. van de Linde.
- "Bookkeeping for Accountant Students," by L. R. Dicksee.
- "Bookkeeping for Company Secretaries," by L. R. Dicksee.
- "Brewers' Accounts," by W. Harris.
- "Company-Secretary," by W. H. Fox.
- "Commercial Handbook, Warne's Standard," by W. J. Gordon.
- "Depreciation of Factories, &c.," by E. Matheson.
- "Depreciation Tables, Comparative," by L. R. Dicksee.
- "Drapers' Accounts," by a Corporate Accountant.
- "Executorship Accounts," by O. H. Caldicott.
- "Executorship Accounts," by F. & A. F. Whinney.
- "Executorship Accounts, Student's Guide to," by R. N. Carter.
- "Factories, Commercial Organisation of," by J. S. Lewis.
- "Factory Accounts," by Garcke & Fells.
- "Farmers and Estate Owners, Bookkeeping for," by J. M. Woodman.
- "Foreign Exchanges, A B C of," by G. Clare.
- "Foreign Exchanges," by Goschen.
- "Friendly Societies' Accounts," by G. C. Oke.
- "Gold Mining and Exploration Companies, Accounts of," by T. Donald.
- "Goodwill and its Treatment in Accounts," by Dicksee & Stevens.
- "Hotel Accounts," by G. S. Whatley.
- "Income Tax Practice, Guide to," by Murray & Carter.

- "Interest, &c., Tables of," by T. B. Gumershall.
- "Interest Tables," by J. King.
- "Life Assurance Accounts," by Sprague.
- "Life Assurance Bookkeeping," by McLauchlan.
- "Mortgage or Loan Tables," by T. D. Challoner.
- "Newspaper Accounts," by Norton & Feasey.
- "Profit-Sharing, Rawson's Precedents on."
- "Publishers' Accounts," by C. E. Allen.
- "Railway Accounts and Finance," by J. A. Fisher.
- "Shopkeepers' Accounts," by S. B. Quin.
- "Sinking Funds," by R. L. Nash.
- "Solicitors' Bookkeeping," by Kain.
- "Solicitors' Bookkeeping," by J. M. Woodman.
- "Solicitors, New System of Bookkeeping for," by S. Hodsoll.
- "Stock Exchange Accounts," by R. Warner.
- "Stock Exchange Accounts," by S. H. M. Killik.
- "Textile Manufacturers' Bookkeeping," by G. P. Norton.

The back volumes of *The Accountant*, *The Accountants' Journal*, and the *Accountants' Manual* also contain numerous articles and lectures upon almost every class of accounts.

. All the above works may be obtained from

Messrs. GEE & Co., 62 Moorgate Street, London, E.C.

APPENDIX F.

COMPANIES ACT 1900.

63 and 64 Vict. c. 48.

Allotment.

4.—(1) No allotment shall be made of any share capital of a company offered to the public for subscription, unless the following conditions have been complied with, namely—

(a) the amount (if any) fixed by the memorandum or articles of association and named in the prospectus as the minimum subscription upon which the directors may proceed to allotment : or

(b) if no amount is so fixed and named, then the whole amount of the share capital so offered for subscription,

has been subscribed, and the sum payable on application for the amount so fixed and named, or for the whole amount offered for subscription, has been paid to and received by the company.

(2) The amount so fixed and named and the whole amount aforesaid shall be reckoned exclusively of any amount payable otherwise than in cash, and is in this Act referred to as the minimum subscription.

(3) The amount payable on application on each share shall not be less than five per cent. of the nominal amount of the share.

(4) If the conditions aforesaid have not been complied with on the expiration of forty days after the first issue of the prospectus, all money received from applicants for shares shall be forthwith repaid to the applicants without interest, and, if any such money is not so repaid within forty-eight days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of five per centum per annum from the expiration of the forty-eight days : Provided that a director shall not be liable if he proves that the loss of the money was not due to any misconduct or negligence on his part.

(5) Any condition requiring or binding any applicant for shares to waive compliance with any requirement of this section shall be void.

(6) This section, except subsection (3) thereof, shall not apply to any allotment of shares subsequent to the first allotment of shares offered to the public for subscription.

5.—(1) An allotment made by a company to an applicant in contravention of the foregoing provisions of this Act shall be voidable at the instance of the applicant within one month after the holding of the statutory meeting of the company and not later, and shall be so voidable notwithstanding that the company is in course of being wound up.

(2) If any director of a company knowingly contravenes or permits or authorises the contravention of any of the foregoing provisions of this Act with respect to allotment he shall be liable to compensate the company and the allottee respectively for any loss, damages, or costs which the company or the allottee may have sustained or incurred thereby: Provided that proceedings to recover such loss, damages, or costs shall not be commenced after the expiration of two years from the date of the allotment.

6.—(1) A company shall not commence any business or exercise any borrowing powers unless—

(a) shares held subject to the payment of the whole amount thereof in cash have been allotted to an amount not less in the whole than the minimum subscription; and

(b) every director of the company has paid to the company on each of the shares taken or contracted to be taken by him, and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment on the shares offered for public subscription; and

(c) there has been filed with the registrar a statutory declaration by the secretary or one of the directors, in the prescribed form, that the aforesaid conditions have been complied with.

(2) The registrar shall, on the filing of this statutory declaration, certify that the company is entitled to commence business, and that certificate shall be conclusive evidence that the company is so entitled.

(3) Any contract made by a company before the date at which it is entitled to commence business shall be provisional only, and shall not be binding on the company until that date, and on that date it shall become binding.

(4) Nothing in this section shall prevent the simultaneous offer for subscription of any shares and debentures or the receipt of any application.

(5) If any company commences business or exercises borrowing powers in contravention of this section, every person who is responsible for the contravention shall, without prejudice to any other liability, be liable to a fine not exceeding fifty pounds for every day during which the contravention continues.

(6) Nothing in this section shall apply to a company registered before the commencement of this Act.

(7) This section shall not apply to any company where there is no invitation to the public to subscribe for its shares.

7.—(1) Whenever a company limited by shares makes any allotment of its shares, the company shall within one month thereafter file with the registrar—

(a) a return of the allotments, stating the number and nominal amount of the shares comprised in the allotment, the names, addresses, and descriptions of the allottees, and the amount (if any) paid or due and payable on each share; and

(b) in the case of shares allotted in whole or in part for a consideration other than cash, a contract in writing constituting the title of the allottee to such allotment, together with any contract of sale, or for services or other consideration in respect of which such allotment was made, such contracts being duly stamped, and a return stating the number and nominal amount of shares so allotted, the extent to which they are to be treated as paid up, and the consideration for which they have been allotted.

(2) If default is made in complying with the requirements of this section, every director, manager, secretary, or other officer of the company, who is knowingly a party to the default, shall be liable to a fine not exceeding fifty pounds for every day during which the default continues.

8.—(1) Upon any offer of shares to the public for subscription, it shall be lawful for a company to pay a commission to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, if the payment of the commission and the amount or rate per cent. of the commission paid or agreed to be paid are respectively authorised by the articles of association and disclosed

in the prospectus, and the commission paid or agreed to be paid does not exceed the amount or rate so authorised.

(2) Save as aforesaid no company shall apply any of its shares or capital money either directly or indirectly in payment of any commission, discount, or allowance, to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, whether the shares or money be so applied by being added to the purchase-money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of the nominal purchase-money or contract price, or otherwise.

(3) But nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay.

10.—(1) Every prospectus issued by or on behalf of a company, or by or on behalf of any person who is or has been engaged or interested in the formation of the company, must state—

- (a) the contents of the memorandum of association, with the names, descriptions, and addresses of the signatories, and the number of shares subscribed for by them respectively; and the number of founders' or management shares, if any, and the nature and extent of the interest of the holders in the property and profits of the company; and
- (b) the number of shares, if any, fixed by the articles of association as the qualification of a director, and any provision in the articles of association as to the remuneration of the directors; and
- (c) the names, descriptions, and addresses of the directors or proposed directors; and
- (d) the minimum subscription on which the directors may proceed to allotment, and the amount payable on application and allotment on each share; and in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment, and the amount actually allotted; and the amount, if any, paid on such shares; and
- (e) the number and amount of shares and debentures issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which such shares or debentures have been issued or are proposed or intended to be issued; and

- (f) the names and addresses of the vendors of any property purchased or acquired by the company, or proposed so to be purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus, or the purchase or acquisition of which has not been completed at the date of publication of the prospectus, and the amount payable in cash, shares, or debentures, to the vendor, and where there is more than one separate vendor, or the company is a sub-purchaser, the amount so payable to each vendor ; and
 - (g) the amount (if any) paid or payable as purchase-money in cash, shares, or debentures, of any such property as aforesaid, specifying the amount payable for goodwill ; and
 - (h) the amount (if any) paid or payable as commission for subscribing or agreeing to subscribe, or procuring or agreeing to procure subscriptions, for any shares in the company, or the rate of any such commission ; and
 - (i) the amount or estimated amount of preliminary expenses ; and
 - (j) the amount paid or intended to be paid to any promoter and the consideration for any such payment ; and
 - (k) the dates of and parties to every material contract, and a reasonable time and place at which any material contract or a copy thereof may be inspected : Provided that this requirement shall not apply to a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company, or to any contract entered into more than three years before the date of publication of the prospectus ; and
 - (l) the names and addresses of the auditors (if any) of the company ; and
 - (m) full particulars of the nature and extent of the interest (if any) of every director in the promotion of or in the property proposed to be acquired by the company, with a statement of all sums paid or agreed to be paid to him in cash or shares by any person either to qualify him as a director or otherwise for services rendered by him in connection with the formation of the company.
- (2) For the purposes of this section every person shall be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where—
- (a) the purchase-money is not fully paid at the date of publication of the prospectus ; or

- (b) the purchase-money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus; or
- (c) the contract depends for its validity or fulfilment on the result of such issue.
- (3) Where any of the property to be acquired by the company is to be taken on lease, this section shall apply as if the expression "vendor" included the lessor, and the expression "purchase-money" included the consideration for the lease, and the expression "sub-purchaser" included a sub-lessee.
- (4) This section shall not apply to a circular or notice inviting existing members or debenture-holders of a company to subscribe for further shares or debentures, but, subject as aforesaid, this section shall apply to any prospectus whether issued on or with reference to the formation of a company or subsequently: Provided that—
- (a) the requirements as to the memorandum of association, and the qualification, remuneration, and interest of directors, the names, descriptions, and addresses of directors or proposed directors, and the amount or estimated amount of preliminary expenses, shall not apply in the case of a prospectus published more than one year after the date at which the company is entitled to commence business; and
- (b) in the case of a prospectus published more than one year after the date at which the company is entitled to commence business, the obligation to disclose all material contracts shall be limited to a period of two years immediately preceding the publication of the prospectus.
- (5) Any condition requiring or binding any applicant for shares or debentures to waive compliance with any requirement of this section, or purporting to affect him with notice of any contract, document, or matter not specifically referred to in the prospectus, shall be void.
- (6) Where any such prospectus as is mentioned in this section is published as a newspaper advertisement, it shall not be necessary to specify the contents of the memorandum of association or the signatories thereto, and the number of shares subscribed for by them.
- (7) In the event of non-compliance with any of the requirements of this section, a director or other person responsible for the prospectus shall not incur any liability by reason of the non-compliance, if he proves that—

(a) as regards any matter not disclosed, he was not cognisant thereof ;
or

(b) the non-compliance arose from an honest mistake of fact on his part.

Provided that in the event of non-compliance with the requirements contained in paragraph (m) of sub-section (1) of this section no director or other person shall incur any liability in respect of such non-compliance unless it be proved that he had knowledge of the matters not disclosed.

(8) Nothing in this section shall limit or diminish any liability which any person may incur under the general law apart from this section.

11.—A company shall not prior to the statutory meeting vary the terms of a contract referred to in the prospectus, except subject to the approval of the statutory meeting.

Statutory Meeting.

12.—(1) Every company limited by shares and registered after the commencement of this Act shall, within a period of not less than one month or more than three months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which shall be called the statutory meeting.

(2) The directors shall, at least seven days before the day on which the meeting is held, forward to every member of the company a report certified by not less than two directors of the company, or, where there are less than two directors, by the sole director and manager, stating—

(a) the total number of shares allotted, distinguishing shares allotted as fully or partly paid up otherwise than in cash, and stating in the case of shares partly paid up the extent to which they are so paid up, and in either case the consideration for which they have been allotted ;

(b) the total amount of cash received by the company in respect of such shares, distinguished as aforesaid ;

(c) an abstract of the receipts and payments of the company on Capital Account to the date of the report, and an account or estimate of the preliminary expenses of the company ;

(d) the names, addresses, and descriptions of the directors, auditors (if any), manager (if any), and secretary of the company ; and

- (e) the particulars of any contract, the modification of which is to be submitted to the meeting for its approval, together with the particulars of the modification or proposed modification.
- (3) The report shall, so far as it relates to the shares allotted by the company, and to the cash received in respect of such shares, and to the receipts and payments of the company on Capital Account, be certified as correct by the auditors, if any, of the company.
- (4) The directors shall cause a copy of the report, certified as by this section required, to be filed with the registrar forthwith after the sending thereof to the members of the company.
- (5) The directors shall cause a list showing the names, descriptions, and addresses of the members of the company, and the number of shares held by them respectively, to be produced at the commencement of the meeting, and to remain open and accessible to any member of the company during the continuance of the meeting.
- (6) The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company, or arising out of the report, whether previous notice has been given or not, but no resolution of which notice has not been given in accordance with the articles of association may be passed.
- (7) The meeting may adjourn from time to time, and at any such adjourned meeting any resolution of which notice has been given in accordance with the articles of association, either before or subsequently to the former meeting, may be passed, and the adjourned meeting shall have the same powers as an original meeting.
- (8) If default is made in filing such report as aforesaid or in holding the statutory meeting, then, at the expiration of fourteen days after the last day on which the meeting ought to have been held, any shareholder may petition the Court for the winding up of the company, and upon the hearing of the petition the Court may either direct that the company be wound up, or give directions for the report being filed or a meeting being held, or make such other order as may be just, and may order that the costs of the petition be paid by any persons who in the opinion of the Court are responsible for the default.

Mortgages and Charges.

14.—(1) Every mortgage or charge created by a company after the commencement of this Act and being either—

- (a) a mortgage or charge for the purpose of securing any issue of debentures; or

- (b) a mortgage or charge on uncalled capital of the company ; or
- (c) a mortgage or charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale ; or

(d) a floating charge on the undertaking or property of the company, shall, so far as any security on the company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the company, unless filed with the registrar for registration in manner required by this Act within twenty-one days after the date of its creation, but without prejudice to any contract or obligation for repayment of the money thereby secured.

(2) Where the mortgage or charge comprises property outside the United Kingdom, it shall, so far as that property is concerned, be sufficient compliance with the requirements of this section, if a deed purporting to specifically charge such property be registered notwithstanding that further proceedings may be necessary to make such mortgage or charge valid or effectual according to the law of the country in which such property is situate.

(3) The registrar shall keep, with respect to each company, a register in the prescribed form of all such mortgages and charges created by the company after the commencement of this Act, and requiring registration under this section, and shall, on payment of the prescribed fee, enter in the register, with respect to every such mortgage or charge, the date of creation, the amount secured by it, short particulars of the property mortgaged or charged, and the names of the mortgagees or persons entitled to the charge.

(4) Provided that where a series of debentures containing any charge to the benefit of which the debenture-holders of that series are entitled *pari passu* is created by a company, it shall be sufficient to enter on the register—

- (a) the total amount secured by the whole series ; and
- (b) the dates of the resolutions creating the series and of the covering deed, if any, by which the security is created or defined ; and
- (c) a general description of the property charged ; and
- (d) the names of the trustees, if any, for the debenture-holders.

(5) Where more than one issue is made of debentures in the same series, the company may require the registrar to enter on the register the date and amount of any particular issue, but an omission to do this shall not affect the validity of the debentures issued.

(6) The registrar shall give a certificate under his hand of the registration of any mortgage or charge registered in pursuance of this

section, stating the amount thereby secured (which certificate shall be conclusive evidence that the requirements of this section as to registration have been complied with), and the company shall cause a copy of the certificate so given to be endorsed on every debenture or certificate of debenture stock which is issued by the company, and the payment of which is secured by the mortgage or charge so registered.

(7) It shall be the duty of the company to register every mortgage or charge created by the company and requiring registration under this section, and for that purpose to supply the registrar with the particulars required for registration; but any such mortgage or charge may be registered on the application of any person interested therein.

(8) The register kept, in pursuance of this section, of the mortgages and charges of each company shall be open to inspection by any person on payment of the prescribed fee, not exceeding one shilling for each inspection.

(9) Every company shall cause a copy of every instrument creating any mortgage or charge requiring registration under this section to be kept at the registered office of the company, and to be open to inspection by the members and creditors of the company on payment of such fee, not exceeding one shilling for each inspection, as may be fixed by the regulations of the company. Provided that in the case of a series of uniform debentures a copy of one such debenture shall be sufficient.

15.—A Judge of the High Court, on being satisfied that the omission to register a mortgage or charge within the time required by this Act, or the omission or misstatement of any particular with respect to any such mortgage or charge, was accidental, or due to inadvertence or to some other sufficient cause, or is not of a nature to prejudice the position of creditors or shareholders of the company, or that on other grounds it is just and equitable to grant relief may, on the application of the company or any person interested, and on such terms and conditions as seem to the Judge just and expedient, order that the time for registration be extended, or, as the case may be, that the omission or misstatement be rectified.

16.—The registrar may, on evidence being given to his satisfaction that the debt for which any registered mortgage or charge was given has been paid or satisfied, order that a memorandum of satisfaction be entered on the register, and shall if required furnish the company with a copy thereof.

17.—The registrar shall keep a chronological index, in the prescribed form and with the prescribed particulars, to the mortgages or charges registered under this Act.

18.—If any company makes default in complying with the requirements of this Act as to the registration of any mortgage or charge created by the company, the company and every director, manager, and other officer of the company, who knowingly and wilfully authorised or permitted such default shall, without prejudice to any other liability, be liable on summary conviction to a fine not exceeding one hundred pounds; and if any person knowingly and wilfully authorises or permits the delivery of any debenture or certificate of debenture stock required by this Act to be registered, without a copy of the certificate of the registrar being endorsed upon it, he shall, without prejudice to any other liability, be liable on summary conviction to a fine not exceeding one hundred pounds.

Annual Summary.

19.—(1) The summary mentioned in section twenty-six of the Companies Act 1862 shall be so framed as to distinguish between the shares issued for cash and the shares issued otherwise than for cash or only partly for cash, and shall, in addition to the particulars required by that section to be specified, also specify—

- (a) the total amount of debt due from the company in respect of all mortgages and charges which require registration under this Act, or which would require such registration if created after the commencement of this Act; and
- (b) the names and addresses of the persons who are the directors of the company at the date of the summary.

(2) The list and summary mentioned in the said section twenty-six must be signed by the manager or by the secretary of the company.

20.—Sections forty-five and forty-six of the Companies Act 1862 shall apply to companies having a capital divided into shares, and the words “and not having a capital divided into shares” in those sections shall be repealed.

Audit.

21.—(1) Every company shall at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting.

(2) If an appointment of auditors is not made at an annual general meeting, the Board of Trade may, on the application of any member of the company, appoint an auditor of the company for the current year, and fix the remuneration to be paid to him by the company for his services.

(3) A director or officer of the company shall not be capable of being appointed auditor of the company.

(4) The first auditors of the company may be appointed by the directors before the statutory meeting, and if so appointed shall hold office until the first annual general meeting, unless previously removed by a resolution of the shareholders in general meeting, in which case the shareholders at such meeting may appoint auditors.

(5) The directors of a company may fill any casual vacancy in the office of auditor, but while any such vacancy continues the surviving or continuing auditor or auditors, if any, may act.

22.—The remuneration of the auditors of a company shall be fixed by the company in general meeting, except that the remuneration of any auditors appointed before the statutory meeting, or to fill any casual vacancy, may be fixed by the directors.

23.—Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors, and the auditors shall sign a certificate at the foot of the Balance Sheet stating whether or not all their requirements as auditors have been complied with, and shall make a report to the shareholders on the accounts examined by them, and on every Balance Sheet laid before the company in general meeting during their tenure of office; and in every such report shall state whether, in their opinion, the Balance Sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company; and such report shall be read before the company in general meeting.

False Statements.

28.—If any person in any return, report, certificate, Balance Sheet, or other document, required by or for the purposes of this Act, wilfully makes a statement false in any material particular, knowing it to be false, he shall be guilty of a misdemeanour, and shall be liable on conviction on indictment to imprisonment for a term not exceeding two years, with or without hard labour, and on summary conviction to imprisonment for a term not exceeding four months, with or without hard labour, and in either case to a fine in lieu of or in addition to such imprisonment as aforesaid: Provided that the fine imposed on summary conviction shall not exceed one hundred pounds.

Supplemental.

31.—This Act shall, except as otherwise expressed, apply to every company, whether formed before or after the commencement of this Act.

32.—The Companies (Winding-up) Act 1890, and this Act, shall have effect as part of the Companies Act 1862; but nothing in this section shall be construed as extending the Companies (Winding-up) Act 1890 to Scotland or Ireland.

33.—(1) Section twenty-five of the Companies Act 1867, and the other enactments mentioned in the schedule to this Act, to the extent specified in the third column of that schedule, are hereby repealed.

(2) No proceedings under section twenty-five of the Companies Act 1867 shall be commenced after the commencement of this Act.

34.—This Act shall apply to Scotland, subject to the following provisions and modifications:—

- (1) "Solicitor of the High Court" shall mean enrolled law agent;
- (2) The provisions of this Act with respect to the registration of mortgages and charges shall not apply to companies registered in Scotland;
- (3) All prosecutions for offences or fines shall be at the instance of the Lord Advocate or a procurator fiscal as the Lord Advocate may direct.

35.—This Act shall, except as otherwise expressed, come into operation on the first day of January one thousand nine hundred and one.

36.—This Act may be cited as the Companies Act 1900, and may be cited with the Companies Acts 1862 to 1898.

SCHEDULE.

ENACTMENTS REPEALED.

Session and Chapter	Short Title	Extent of Repeal
25 & 26 Vict. c. 89	The Companies Act 1862	Sections eighteen, from "A certificate" to the end of the section In sections forty-five and forty-six, the words "and not having a capital divided into shares" Section one hundred and ninety-two
30 & 31 Vict. c. 131	The Companies Act 1867	Sections twenty-five, thirty-eight, and thirty-nine

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